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IN THE
Supreme Court of the United States
OCTOBER TERM, 1989

DOWNRIVER COMMUNITY FEDERAL CREDIT UNION
and WOOD PRODUCTS CREDIT UNION,
Petitioners,

v.

PENN SQUARE BANK, through its Receiver,
FEDERAL DEPOSIT INSURANCE CORPORATION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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QUESTIONS PRESENTED

1. Whether the ratable distribution requirement of the National Bank Act preempts the pre-insolvency state law right of a depositor to a constructive trust on funds fraudulently obtained by the bank prior to insolvency?

2. Whether, if there is such preemption, and a federal common law rule is to be established, the ratable distribution requirement of the National Bank Act requires the beneficial owner of funds held in constructive trust by a failed national bank to prove that other creditors of the bank could not even potentially have equal rights to the funds?

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

To The Honorable, The Chief Justice And Associate Justices Of The Supreme Court Of The United States:

Petitioners Downriver Community Federal Credit Union and Wood Products Credit Union respectfully pray that a writ of certiorari issue to review the judgment and opinion by the United States Court of Appeals for the Tenth Circuit entered in the above-titled case on July 3, 1989.

OPINIONS BELOW

The July 3, 1989, opinion of the United States Court of Appeals for the Tenth Circuit is reported at 879 F.2d 754. The opinion is reprinted as Appendix A hereto, *infra*, at 1a.

The Order of the United States District Court for the Western District of Oklahoma, from which an appeal was taken by the Respondent to the court of appeals, is not published. The Order, dated December 15, 1986, is reprinted as Appendix B hereto, *infra*, at 22a. In addition, the district court issued an order relating to the same issue currently on appeal, denying the Respondent's motion for a new trial. This order, dated March 27, 1987, is reprinted as Appendix D hereto, *infra*, at 46a.

JURISDICTION

The judgment of the court of appeals was entered on July 3, 1989. On September 5, 1989, the court of appeals denied Petitioners' petition for rehearing. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254 (1). On September 8, 1989, this Court granted Petitioners a thirty day extension of time until October 31, 1989 to file this Petition for Writ of Certiorari (Docket No. 89-A-198).

STATUTES INVOLVED

12 U.S.C. § 194 of the National Bank Act provides:

> § 194. *Dividends on adjusted claims; distribution of assets.* From time to time, after full provision has been first made for refunding to the United States any deficiency in redeeming the notes of such [national banking] association, the comptroller shall make a ratable dividend of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and, as the proceeds of the assets of such association are paid over to him, shall make further dividends on all claims previously proved or adjudicated; and the remainder of the proceeds, if any, shall be paid over to the shareholders of such association, or their legal representatives, in proportion to the stock by them respectively held. R.S. 5236.

12 U.S.C. § 91 of the National Bank Act provides:

> § 91. *Transfers by bank and other acts in contemplation of insolvency.* All transfers of the notes, bonds, bills of exchange, or other evidences of debt owing to any national banking association, or of deposits to its credit; all assignments of mortgages, sureties on real estate, or of judgments or decrees in its favor; all deposits of money, bullion, or other valuable thing for its use, or for the use of any of its shareholders or creditors; and all payments of money to either, made after the commission of an act of insolvency, or in contemplation thereof, made with a view to prevent the application of its assets in the manner prescribed by this chapter, or with a view to the preference of one creditor to another, except in the payment of its circulating notes, shall be utterly null and void; and no attachment, injunction, or execution, shall be issued against such association or its property before final judgment in any suit, action, or proceeding, in any State, county, or municipal court. R.S. 5242.

STATEMENT OF THE CASE

Petitioners Downriver Community Federal Credit Union ("Downriver") and Wood Products Credit Union ("Wood Products") placed uninsured deposits in Penn Square Bank, N.A. in reliance on the bank's fraudulently misleading financial statements in early 1982. On July 5, 1982 Penn Square Bank was declared insolvent and the Federal Deposit Insurance Corporation ("FDIC") was appointed receiver for the bank. The Petitioners sued the FDIC as receiver to recover their uninsured funds on the grounds that the bank held the funds in constructive trust for the Petitioners. Petitioners argued that because the bank obtained their funds by fraud, the bank never took financial title to the funds. The funds therefore were held in constructive trust for the benefit of the Petitioners, and were not assets of the bank when it failed. The trust funds were traced to the hands of the

receiver, and thus were not subject to ratable distribution under the National Bank Act, 12 U.S.C. § 194. Consequently, the Petitioners were entitled to recover the funds in their entirety. The United States District Court for the Western District of Oklahoma had original jurisdiction of the Petitioners' actions pursuant to 28 U.S.C. § 1331, 28 U.S.C. § 1332(a), 12 U.S.C. § 1819 (Fourth) (now 12 U.S.C. § 1819(b)(2)(A)) and 12 U.S.C. § 21, *et seq.*

Downriver requested and received Penn Square Bank's financial statements directly from the bank. Downriver analyzed this data and relied on it in placing its uninsured deposits in Penn Square Bank. Downriver had $3,938,240.00 in uninsured deposits at the bank when it was declared insolvent and closed on July 5, 1982.

Wood Products obtained the financial data contained in Penn Square Bank's financial statements through its money broker, Professional Asset Management, Inc. Wood Products analyzed this data and relied on it in placing its uninsured deposits in the bank. Wood Products had $404,583.32 in uninsured deposits at the bank when the bank was closed.

Although the Petitioners' cases were consolidated, Downriver sought and received a jury trial on the issue of liability, and Wood Products' case was tried to the court. The jury returned a verdict in favor of Downriver on the issue of fraudulent inducement. The district court independently found in favor of Wood Products on the same issue.

In a subsequent equitable proceeding, the district court found by clear and convincing evidence that the Petitioners had satisfied the factual and legal prerequisites for imposition of a constructive trust under Oklahoma law because (1) the Petitioners deposited funds above the federally insured amount in reliance on Penn Square Bank's fraudulent financial statements, (2) the bank's financial statements materially misrepresented the condi-

tion of the bank by, *inter alia*, grossly overstating capital and income, (3) the Petitioners' uninsured deposits augmented the assets of the receivership estate and (4) the deposits could be traced into the hands of the receiver. The district court also found that the imposition of a constructive trust would be equitable because there was no evidence of other creditors' reliance, and any other uninsured depositors who had relied on the fraudulent financial statements could have proven their own trust claims by bringing suit or intervening in the case. The district court found that denial of recovery to Petitioners would unjustly enrich other creditors of Penn Square Bank who would thereby benefit from the bank's fraud.

As for the ratable distribution requirement of the National Bank Act, the district court held that that provision did not preclude identification and recovery of property that does not rightfully belong to the bank. The district court ruled that since the Petitioners' constructive trusts vested under Oklahoma law at the time of the original deposits prior to the bank's insolvency, the Petitioners' funds were never assets of the bank, and were not subject to the ratable distribution requirement of the National Bank Act.

There was no evidence at trial that any other uninsured depositor had also relied on the fraudulent financial statements. It was undisputed that the largest creditor, the FDIC (47 percent of the total dollar value of all receiver certificates), did not rely on the bank's financial statements and was not similarly situated to the Petitioners; the FDIC's claim against the receivership estate was based solely on the insurance payout to insured depositors, whose deposits were unaffected by the bank's financial condition.

Accordingly, the district court issued an order imposing constructive trusts in favor of Downriver and Wood Products in the amounts of $1,722,208.58 and $182,062.50, respectively. These amounts represented the uninsured

amounts on deposit at the bank on the day it was closed, less dividends paid by the receiver in the interim.

The FDIC as receiver appealed to the United States Court of Appeals for the Tenth Circuit pursuant to 28 U.S.C. § 1291. The FDIC did not appeal the fraud verdict or any factual finding by the trial court; the FDIC only appealed the district court's legal ruling that the constructive trusts were not preempted by the National Bank Act.

The United States Court of Appeals for the Tenth Circuit reversed the district court's decision. The court of appeals acknowledged that the Petitioners would be entitled to recover their constructive trusts under Oklahoma law. 879 F.2d at 763 (Appendix A at 18a). However, the Tenth Circuit held that the Petitioners' pre-insolvency property rights under Oklahoma law were preempted by the federal policies of ratable distribution and orderly administration of the receiver's estate embodied in the National Bank Act. The court thereby freed itself to devise its "own principles" governing recovery of constructive trusts arising from fraud. 879 F.2d at 761 Appendix A at 13a).

The Tenth Circuit next invented a new federal common law rule under which all constructive trust claims for fraud belong to the receiver where the fraud potentially harmed all creditors, regardless of whether there is any evidence that all creditors were actually defrauded. The court denied recovery by the Petitioners because the financial statements upon which their constructive trusts were based were publicly available. Petitioners filed a petition for rehearing and suggestion for rehearing *en banc* which the court of appeals denied on September 5, 1989. *See* Appendix E at 49a.

REASONS FOR GRANTING THE WRIT

I. THE TENTH CIRCUIT'S DECISION ENCROACHES ON AREAS OF LAW TRADITIONALLY RESERVED BY CONGRESS FOR THE STATES.

This is a case of national importance. The Tenth Circuit's decision dramatically extends the reach of federal regulation to areas of law traditionally reserved by Congress and this Court for regulation by the states. The decision ignores a century of settled law consistently applied in federal liquidation proceedings, both under the National Bank Act and under the Bankruptcy Act. As a result, the Tenth Circuit's decision foments inconsistent application of the policy of ratable distribution among creditors of the same class, and potentially alters the judicial treatment of hundreds of millions of dollars of uninsured deposits held by banks and thrifts nationwide.

When Congress enacted the National Bank Act and the Bankruptcy Act, it established a uniform federal standard for determining what constitutes the assets of the insolvent estate and how those assets should be distributed among creditors of the same class.[1] The assets of the insolvent (and hence of the receivership estate) are fixed as of the date of the declaration of insolvency and ap-

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[1] Although the Bankruptcy Act is not directly applicable to national bank liquidations, federal courts have generally looked to bankruptcy principles for guidance in the liquidation of national banks. *See, e.g., Scott v. Armstrong*, 146 U.S. 499, 511 (1892); *Kennedy v. Boston Continental Nat'l Bank*, 11 F. Supp. 611 (D. Mass. 1935), *rev'd on other grounds*, 84 F.2d 592 (1st Cir.), *cert. denied* 300 U.S. 684 (1937). As discussed herein, the policies at issue in this case, and Congress's intent with respect to the application of those policies, are identical to those adopted by Congress for federal bankruptcy proceedings. *See infra* at 7-9. Accordingly, it is appropriate that the Court look for guidance to expressions of Congressional will with respect to federal bankruptcy proceedings as well as national bank liquidations in determining the balance which Congress intended between federal and state interests in this area.

pointment of a receiver (under the National Bank Act) or petition for bankruptcy (under the Bankruptcy Act).[2]

Under both statutory schemes, Congress intended that federal courts look to state law to determine what property rights of the debtor had vested prior to, and not in contemplation of, insolvency. And as to trusts in particular, Congress has been explicit: the creation of trusts is determined by state law and the beneficiaries of a constructive trust under state law are entitled to post-insolvency recovery of all trust property traced to the insolvent estate, notwithstanding the ratable distribution requirement. For instance, Congress expressly stated its understanding in the legislative history of the Bankruptcy Act that constructive trusts arise at the time the duty to make restitution arises and that such property does not become an asset of the insolvent estate but belongs to the beneficial owner.[3] Similarly, by enacting Section 92a of

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[2] *See* 12 U.S.C. § 192; *Scott v. Armstrong*, 146 U.S. 499 (1892) (National Bank Act); *Peoples-Ticonic Nat'l Bank v. Stewart*, 86 F.2d 359 (1st Cir. 1936) (same); 11 U.S.C. § 541 (Bankruptcy Act); *In re N.S. Garrott & Sons*, 772 F.2d 462, 467 (8th Cir. 1985) (same).

[3] *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 368 (1977), *reprinted in* 1978 U.S. Code Cong. & Ad. News 5787, 6324; S. Rep. No. 989, 95th Cong., 2d Sess. 82 (1978), *reprinted in* 1978 U.S. Code Cong. & Ad. News 5868. The following language contained in H.R. Rep. No. 595, 95th Cong., 1st Sess. 368 (1977) (emphasis added), unambiguously states the intent of Congress respecting pre-insolvency constructive trusts under the bankruptcy code:

> Situations occasionally arise where property ostensibly belonging to the debtor will actually not be property of the debtor, but will be held in trust for another. For example, if the debtor has incurred medical bills that were covered by insurance, and the insurance company had sent payment of the bills to the debtor before the debtor had paid the bill for which the payment was reimbursement, *the payment would actually be held in constructive trust for the person to whom the bill was owed.*

See also cases cited *infra* at 10 n.5.

the National Bank Act (12 U.S.C. § 92a), Congress indicated its intention that the creation of a trust relationship between a national bank and its customer, and the right of a national bank to act as trustee, turn upon the law of the state where the bank is located.[4]

Federal courts have shown remarkable consistency in applying state law to determine whether a constructive trust was created prior to insolvency. For instance, this Court ruled in *Jaffke v. Dunham*, 352 U.S. 280, 281 (1957) (per curiam), that in a federal bankruptcy proceeding state law provided the rule of decision to determine whether a constructive trust was established when the bankrupt obtained funds by fraud. Similarly, in the context of a national bank insolvency, the Seventh Circuit held that state law is presumed to apply to the question of pre-insolvency constructive trusts. In *FDIC v. Braemoor Associates*, 686 F.2d 550, 553-554 (7th Cir. 1982), Judge Posner held that, notwithstanding the fact that the FDIC was a party, state law determined existence of a constructive trust because "the absence of any ready-made federal common law . . . and a general reluctance to displace state law without explicit statutory or constitutional direction to do so, support a presumption that state law is adequate and should be adopted by the federal court as the rule of decision". *Cf. Interfirst Bank Abilene, N.A. v. FDIC*, 777 F.2d 1092, 1094 (5th

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[4] *See Blaney v. Florida Nat'l Bank at Orlando*, 357 F.2d 27, 30 (5th Cir. 1966) ("[T]he law of trusts and estates, like the law of domestic relations, is primarily a matter of state concern. That Congress, too, recognized this fact seems obvious from the provisions of 12 U.S.C. § 92a itself, making the right of national banks to act as trustees, executors, administrators or in any other fiduciary capacity turn upon the law of the state in which such national bank is located." (citations omitted)). Although Section 92a applies to trusts generally rather than to constructive trusts in particular, the statute taken as a whole is a strong statement of Congressional intent with regard to the applicability of state law of trusts.

Cir. 1985) (under the National Bank Act state law provided the rule of decision to determine pre-insolvency equitable right to setoff).[5]

The Tenth Circuit actually acknowledged a direct conflict with the Ninth Circuit Court of Appeals on the precise question at issue here, whether federal law preempts state law governing the pre-insolvency creation of a constructive trust upon deposits in a national bank. 879 F.2d at 760 n. 6 (Appendix A at 11a n. 6). In *Reno Nat'l Bank v. Seaborn*, 99 F.2d 482 (9th Cir. 1938), a depositor in a failed national bank claimed a constructive trust on its deposit based on the bank's allegedly fraudulent failure to transfer the funds to another bank. The Ninth Circuit ruled that, in light of *Erie Ry. Co. v. Tompkins*, 304 U.S. 64 (1938), state law provided the rule of decision as to whether the conduct of the bank gave rise to a constructive trust:

> The creditor rights of a depositor of a national bank, by virtue of his loan to the bank and the effects of the conduct of the bank as altering such rights, are determined by the law of the state of the deposit, in the absence of a federal statute creating a different relationship. There is no underlying general federal law determining such rights, and no federal statute denying to a cestui his right against a bank as its trustee, where, in the course of business prior

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[5] Cases under the Bankruptcy Act have uniformly reached identical results. *See, e.g., Sanyo Electric v. Howard's Appliance Corp.*, Case No. 746, slip op. at 3018-19 (2d Cir. April 25, 1989) ("The existence and nature of a debtor's interest, and correspondingly the estate's interest, in property is determined by state law"); *In re FCX, Inc.*, 853 F.2d 1149 (4th Cir. 1988), *cert. denied*, 109 S.Ct. 1118 (1989) (same); *Connecticut General Life Ins. Co. v. Universal Ins. Co.*, 838 F.2d 612 (1st Cir. 1988); *In re Bullion Reserve of North America*, 836 F.2d 1214 (9th Cir. 1988), *cert. denied sub nom. Bozek v. Danning*, 108 S.Ct. 2824, 100 L.Ed.2d 925 (1988); *In re General Coffee Corp.*, 828 F.2d 699, 702-704 (11th Cir. 1987), *cert. denied, sub nom. General Coffee Corp. v. City Nat'l Bank of Miami*, 108 S.Ct. 1470, 99 L.Ed.2d 699 (1988) (estate does not include property acquired by fraud and held in constructive trust).

> to the receivership, such a trust relationship has been created by the conduct of the bank. . . . *The cases holding that state laws cannot determine what preferences should be given in the distribution of an insolvent bank's assets, have no applicability to the question here of the character of the assets prior to and at the time the bank ceases business.*

99 F.2d at 483 (emphasis added) (citation omitted).[6] Contrary to the Tenth Circuit, the Ninth Circuit found no need for nationwide uniformity requiring a federal rule governing the pre-insolvency creation of a trust relationship between a national bank and a depositor. *Id.*[7]

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[6] The Ninth Circuit's rationale echoed the reasoning of this Court in the landmark case of *Scott v. Armstrong*, 146 U.S. 499, 511 (1892), where this Court rejected a similar argument that the ratable distribution requirement of the National Bank Act preempted a depositor's right to setoff, "We cannot believe Congress intended . . . to destroy by implication any right vested at the time of the suspension of a national bank."

[7] A central tenet of the Tenth Circuit's holding is its belief that a nationwide federal rule is necessary because the Petitioners' recovery of constructive trusts under Oklahoma law would be an accident of geography contrary to the federal policy favoring equal treatment of creditors. *See* 879 F.2d at 761, 763 ("[It] is not a question to be decided fortuitously because 'a particular state happened to have the greatest connection in the conflict of laws sense.'" (quoting *D'Oench, Duhme & Co., Inc. v. FDIC*, 315 U.S. 447, 473 (1942) (Jackson, J., concurring)). (Appendix A at 13a-14a and 17a-18a). However, there is no need for federal uniformity regarding the right to a constructive trust for fraudulently obtained deposits because every state's laws are *already* uniform. The Petitioners would be entitled to constructive trusts regardless of the state where the bank was located. In every state, a fraudulent misrepresentation to the public is grounds for a fraud claim by anyone who relies on it. *See* Appendix F at 51a. And in virtually every state, a constructive trust arises when property is obtained by fraud. *See* Appendix G at 53a. The federal interest in ratable distribution of the assets of failed national banks is adequately served by the uniform federal rule requiring augmentation of the bank's assets and tracing of the trust funds. *See infra* at 13 n.9.

Thus, the Tenth Circuit's wholesale rejection of state law is in conflict with this Court and virtually every other circuit. Contrary to the intention of Congress, the decision undermines the authority of states to regulate pre-insolvency trusts and property interests within their borders and threatens to upset the time-honored balance of state and federal interests in this area. In place of that balance, the court substitutes a result-oriented approach to the choice of law which allows federal courts to choose selectively between applying state law or formulating new federal common law, depending on which will maximize assets to be included within the receivership estate. The intended consequence is an expansion of the concept of an "asset" of an insolvent national bank subject to ratable distribution to the FDIC and other creditors. The corollary result is the erosion of traditional state authority over the pre-insolvency commercial relationships between national banks and the creditors with whom they deal in the ordinary course of business.

Moreover, as shown herein, the Tenth Circuit's rejection of state law and adoption of new federal common law rules introduces a dangerous divergence between the National Bank Act and the Bankruptcy Act in determining what constitutes an asset of the insolvent estate and how those assets should be ratably distributed among creditors of the same class.[8] There is no policy justification for different treatment of pre-insolvency constructive trusts under the two statutory schemes.

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[8] Although Congress established different classes of creditors under the two statutory schemes, the policy of ratable distribution of receivership assets among members of the *same* class is identical. Moreover, under both acts property held in trust by the debtor is considered to be completely independent of the respective priority schemes because such property is not even a part of the estate. *See, e.g., United States v. Whiting Pools, Inc.*, 462 U.S. 198, 205 n.10 (1983) ("Congress plainly excluded property of others held by the debtor in trust at the time of the filing of the petition.").

II. THE TENTH CIRCUIT'S DECISION CREATES NEW FEDERAL COMMON LAW RULES FOR NATIONAL BANK RECEIVERSHIPS WHICH ARE CONTRARY TO WELL-ESTABLISHED TRUST PRINCIPLES AND WHICH EFFECTIVELY ABROGATE ALL STATE LAW CONSTRUCTIVE TRUSTS BASED ON FRAUD.

Having rejected the traditional application of state law to determine whether the Petitioners are entitled to pre-insolvency trusts, and having determined that federal common law should be fashioned to control the issue, the Tenth Circuit's decision further undermines traditional state authority in favor of an expanded federal receivership estate by the particular new federal common law rules it creates. Those rules impose an impossible burden of proof on those seeking to enforce state law rights to property held in trust by a national bank and improperly alter the fundamental nature of constructive trusts.

A. The Tenth Circuit Created a Federal Common Law Rule That Erects an Impossible Evidentiary Burden Contrary to Established Law.

Federal courts have traditionally placed a heavy, but not insurmountable, burden on those in federal liquidation proceedings seeking to recover property held by a debtor in constructive trust. The burden may be overcome by clear and convincing evidence that (1) the constructive trust arose prior to and not in contemplation of insolvency, (2) the trust property augmented the assets of the insolvent, and (3) the property could be traced into the hands of the receiver.[9]

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[9] *See, e.g., Blakey v. Brinson*, 286 U.S. 254 (1932); *Connecticut General Life, supra*, 838 F.2d at 612; *General Coffee, supra*, 828 F.2d at 699. In trust cases, federal courts have protected the federal interest in ratable distribution primarily through application of the tracing and augmentation requirements. The rationale is that a trust beneficiary has an interest in particular property, not a lien against the general assets of the debtor's estate. Once the

In the present case, the district court found all three elements by clear and convincing evidence, and neither the FDIC nor the Tenth Circuit disputed those findings. The Tenth Circuit acknowledged that the Petitioners' deposits were fraudulently induced because of their individual reliance on the bank's financial statements, and that the Petitioners would be entitled to constructive trusts if Oklahoma law were applied. *See* 879 F.2d at 763 (Appendix A at 18a). The trusts did not arise in contemplation of insolvency; irrespective of whether Penn Square Bank had failed, the constructive trusts arose under Oklahoma law at the time the Petitioners' funds were fraudulently obtained. As to the other two elements, augmentation and tracing, the Respondent conceded in oral argument before the district court that the Petitioners had proven augmentation and tracing, and the undisputed evidence clearly supports that finding.[10] Thus, under es-

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identifiable property has been dissipated, the beneficiary becomes a general creditor because it is left with only a general, unsecured claim against the estate. *Blakey v. Brinson, supra,* 286 U.S. at 254 (National Bank Act); *Matter of Kennedy & Cohen, Inc.,* 612 F.2d 963, 965-66 (5th Cir.), *cert. denied* 449 U.S. 833 (1980) (Bankruptcy Code). In the case of commingled cash deposited in banks, courts have applied the "lowest intermediate balance" rule to trace the trust fund. The failed bank is presumed to have spent its own cash first, and as long as the amount of cash held by the bank has not fallen below the amount held in trust, the cash remaining is presumed to be the fund held in trust. *See, e.g., Schuyler v. Littlefield,* 232 U.S. 707 (1914) (Bankruptcy Code); *Kershaw v. Jenkins,* 71 F.2d 647, 649 (10th Cir. 1934) (National Bank Act).

[10] The Respondent's counsel acknowledged during trial that the Petitioners had satisfied the requirements of augmentation and tracing:

> MR. RICKETTS: Your Honor, insofar as the two elements . . . augmentation and the tracing to the receivership, I will not spend time on those because, frankly, we do think that under the evidence that was presented in Phase One there was, number one, new money coming into the bank as a result of the reliance on the false financial statement; and the tracing, at least under the cases, would indicate that the amounts being

tablished law, the Petitioners are entitled to recover their funds without any further showing.

The Tenth Circuit, however, in effect abrogated the Petitioners' pre-insolvency state law property rights by raising an additional and insurmountable obstacle to recovery. The court's new rule creates a presumption that all creditors had been equally defrauded and therefore share parity with trust beneficiaries. The court imposed an impossible burden on the Petitioners by requiring them to prove a negative, namely, that other unsecured creditors had *not* been defrauded. Thus, under the federal common law rule created by the court:

> A national bank's fraudulent conduct may give rise to a constructive trust only when the plaintiff can show that the bank's fraud caused a particular harm that is not shared by substantially all other depositors . . . . Any remedy for fraudulent representations that affects, or potentially affects, all creditors belongs to the receiver, who asserts such claims for the benefit of all creditors.

879 F.2d at 762, 764 (Appendix A at 15a, 21a). Under this standard, in order to recover, trust beneficiaries must not only prove their own entitlement, but also must prove that other creditors are not even potentially entitled to the same relief; and other creditors (including the FDIC as the largest creditor) are almost automatically entitled to a share of the trust beneficiaries' trust property because they are presumed to have been equally defrauded. No proof of actual reliance on the bank's

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> claimed by Downriver and Wood Products did not dip below or go below the amounts . . .

Transcript of 11/12/86 at 48. The Petitioners' funds augmented the assets of Penn Square Bank because the funds were new money coming into Penn Square Bank. Penn Square Bank's cash never fell below $19 million between the time of the Petitioners' deposits and the bank's failure, thereby satisfying the "lowest intermediate balance" rule for tracing. *See supra* at 13 n.9.

misrepresentations is required by the Tenth Circuit. The receiver need only assert the slender theoretical possibility that other depositors could have been similarly harmed, and the Petitioners are thereafter required to affirmatively prove otherwise.

No other court has ever adopted such a rule. The closely related decisions of this Court and the various circuit courts awarding constructive trusts when deposits were received by banks which were hopelessly insolvent are analytically identical but diametrically opposed to the Tenth Circuit's holding.[11] In addition, the Tenth Circuit's decision is in direct conflict with a decision by the Eighth Circuit which is exactly on point. In *Fiman v. State of South Dakota*, 29 F.2d 776, 782 (8th Cir. 1928), the receiver anticipated the Tenth Circuit's reasoning by claiming that other uninsured depositors who relied upon a failed bank's misleading financial statements should be presumed to have been defrauded and thereby entitled to equal priority with the constructive trust claimant. The Eighth Circuit rejected the receiver's arguments. It firmly placed the burden on other depositors to establish their own priority, not on the plaintiff to disprove their entitlement to parity.

A presumption of reliance by all creditors is not raised by the mere fact that the bank's fraudulent financial

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[11] In hopeless insolvency cases, federal courts have uniformly required the defrauded depositor to show only that it had deposited funds after the bank was known by management to be hopelessly insolvent; no such depositor was ever required to affirmatively show that other depositors were not defrauded because they had deposited funds *before* the bank was known to be hopelessly insolvent. *See e.g., St. Louis & San Francisco R. Co. v. Johnston*, 133 U.S. 566, 575 (1890); *Carnegie-Illinois Steel Corp. v. Berger*, 105 F.2d 485 (3rd Cir.), *cert. denied*, 308 U.S. 603 (1939); *Standard Oil Co. v. Elliott*, 80 F.2d 158 (4th Cir. 1935); *Federal Reserve Bank v. Omaha Nat'l Bank*, 45 F.2d 511 (8th Cir. 1930), *cert. denied*, 282 U.S. 902 (1931); *O'Neal v. White*, 79 F.2d 835 (4th Cir. 1935), *cert. denied*, 297 U.S. 706 (1936).

statements were available to the public. The Tenth Circuit's federal common law rule inappropriately relies upon *In re Longhorn Securities Litigation*, 573 F. Supp. 255, 272 (W.D. Okla. 1983), to support the proposition that claims based on fraudulent representations that "potentially affect" all depositors belong to the receiver. 879 F.2d at 764-765 (Appendix A at 21a). With regard to the question of fraud claims based on fraudulent published financial statements, however, *Longhorn* and the cases cited therein actually held precisely the opposite.

Longhorn held that "individual depositors . . . may sue directly, in their own right, if they suffer a wrong that is uniquely theirs and not common to all." 573 F. Supp. at 272. Two of the cases cited by *Longhorn* as showing such unique harm involved fraud claims identical to the present case because the claims were based on publicly available financial statements. *See Harmsen v. Smith*, 542 F.2d 496, 499-501 (9th Cir. 1976) (shareholders who suffered separate, individual damages by relying on false bank financial statements may sue directly); *Imperial Supply Co. v. Northern Ohio Bank*, 430 F. Supp. 339, 364-66 (N.D. Ohio 1976) (same); *see also Hurley v. FDIC*, 719 F. Supp. 27 (D. Mass. 1989) (fraud claims based on shareholder reliance on bank's fraudulent public quarterly and annual reports belonged to the individual shareholders, not to the bank receiver). *Longhorn* and the cases cited therein thus directly contradict the Tenth Circuit's ruling. Only derivative injuries predicated on harm caused to the bank itself, as distinguished from injuries suffered directly by an individual depositor or creditor, are claims belonging to the receiver. *See generally* 12B W. Fletcher, *Cyclopedia of the Law of Private Corporations* § 5923.2 (1984) (where shareholders themselves have been defrauded, they may individually sue the wrongdoer, even if *all* shareholders were victims of the fraud). *Longhorn* distinguishes fraud claims arising from individual reliance on misleading financial state-

ments as precisely the kind of unique harm that gives rise to a depositor's individual claim against the receiver.

This analysis is consistent with the treatment of public misrepresentations in the hopeless insolvency cases cited in the Tenth Circuit's decision. In every hopeless insolvency case the bank's false representation of solvency is directed to the public at large. For instance, in *St. Louis & San Francisco R. Co. v. Johnston*, *supra*, this Court noted that the bank's representation of solvency was directed "to complainant and all other persons dealing with [the bank]". 133 U.S. at 577. What distinguishes the individual depositor is its individual reliance on that public misrepresentation. Similarly, what distinguishes the Petitioners in this case is their individual reliance on Penn Square Bank's misrepresentations in its financial statements.

The distinction is magnified by the fact that, according to the FDIC, until the failure of Penn Square Bank few other depositors placed any reliance on the financial statements of banks like Penn Square Bank because of the de facto 100 percent deposit insurance which they expected to receive from the FDIC:

> Since 1960 about three-fourths of failed commercial banks and, until Penn Square Bank, all failures over $100 million in size have been handled in purchase and assumption transactions (P&As) . . . [A]ll depositors and other general creditors are made whole in a P&A. . . .
>
> Many believe that no large American bank will be paid off even if it were allowed to fail, and have acted accordingly. In addition to driving large depositors from smaller to larger banks, this growing perception of almost absolute safety of funds in large institutions *is having the effect of removing the consideration of bank risk from business decisions*. . . .
>
> As a result of [deposit insurance and loan setoffs], *few depositors are exposed to any risk and have rea-*

> *son to be concerned about the financial condition of their banks.*

Federal Deposit Insurance Corporation, *Deposit Insurance in a Changing Environment* at I-6 and III-1 to III-3 (1983) (emphasis added).

In sum, the Tenth Circuit's attempt to apply the rule governing derivative injuries to the Petitioner's constructive trusts is misguided, because the fraud perpetrated by Penn Square Bank was personal to the Petitioners. It is conceivable that *some* uninsured depositors may have relied on the bank's financial statements. But given the certainty that the largest creditor, the FDIC, did not rely on the bank's financial statements, it is inconceivable that *all* Penn Square Bank creditors relied on the financial statements. Those who were actually defrauded should be required to prove their entitlement to higher priority. The Petitioners proved their individual entitlement to recover their trust funds based on time-honored rules for establishing the existence of the trusts and tracing the trust res into the hands of the receiver. The Tenth Circuit's decision to hold otherwise is wholly unsupported and is contrary to the actual findings of the FDIC regarding the practices of uninsured depositors leading up to the Penn Square Bank failure.

The result propounded by the Tenth Circuit would upset the equilibrium established by Congress and the courts between federal interests in national bank liquidations and state interests in regulating pre-insolvency trust relationships and property transfers.[12] The decision

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[12] Congress itself has never seen fit to disturb this balance. Despite the fact that for over a century federal courts have been allowing constructive trusts for uninsured deposits fraudulently obtained by national banks, none of the numerous amendments of the National Bank Act and the Federal Deposit Insurance Act have attempted to limit recovery of such constructive trusts as proposed by the Tenth Circuit. Certainly Congress has indicated a willingness to modify the legal principles applicable to bank receiverships

also breeds inconsistencies between the National Bank Act and the Bankruptcy Act in determining whether property obtained by fraud may be retained for the benefit of a debtor's estate. Property which every federal court for the past century would have treated as belonging to the defrauded party becomes, under the Tenth Circuit's new rule, property of the receivership estate subject to ratable distribution—based solely on the theoretical (but unlikely) possibility that all other creditors were similarly harmed and thus entitled to equal relief if they chose to seek it.[13] The end result is that state authority is further eroded and many general creditors who were not fraud victims receive larger distributions and are unjustly enriched at the expense of the party whose property was fraudulently acquired by the insolvent.

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where it felt such modification was warranted. In the Financial Institutions Reform, Recovery and Enforcement Act of 1989 Congress undertook an extensive overhaul of banking receivership laws. Congress specifically enacted provisions codifying the FDIC's power to preempt contract rights, defenses and counterclaims otherwise available to borrowers under state law. *See* Pub. L. No. 101-73, §§ 212(a) and 217(4), 103 Stat. 183 (1989), *codified at* 12 U.S.C. § 1821(e) and 1823(e); *see also* H.R. Rep. No. 222, 101st Cong., 1st Sess. 502 (1989). Nevertheless, Congress left the state law rights of constructive trust beneficiaries untouched, thereby maintaining the traditional equilibrium.

[13] As noted above, in the present case it is not even theoretically possible that all creditors were defrauded by Penn Square Bank. It is undisputed that the FDIC itself is the largest creditor, holding 47 percent of the dollar value of all receiver certificates. The FDIC was not defrauded by Penn Square Bank. It is a creditor solely by virtue of its rights as subrogee to insured depositors, who were never at risk and never had occasion to rely on the bank's financial statements. Ironically, the FDIC stands to gain the most from the Tenth Circuit's new rule where it is presumed to have equal parity to constructive trust claimants. This fact suggests that the Tenth Circuit's rule could be better characterized as a veiled effort to augment the FDIC insurance fund rather than ensuring equitable distribution of funds that were fraudulently obtained by Penn Square Bank.

B. The Tenth Circuit's Federal Common Law Rule Which Recasts the Nature of a Constructive Trust is Contrary to Established Law.

The Tenth Circuit's decision rejects state law governing the nature and creation of property interests and fashions its own conception of the nature of a constructive trust which is at odds with the weight of authority in almost every jurisdiction, state and federal. Rather than a vested right arising automatically at the time property is wrongfully acquired, the court describes the constructive trust as merely an "equitable fiction . . . [an] attempt to recharacterize [the debtor-creditor] relationship equitably after insolvency." 879 F.2d at 760 (Appendix A at 11a). Furthermore, the court expressly limits its recognition of constructive trusts to those where "the parties intended to form a trust." 879 F.2d at 758, 760 (Appendix A at 7a, 11a).

The Tenth Circuit's decision confounds the distinction between the creation of a property interest and its enforcement, and is contrary to established law governing constructive trusts. A constructive trust arises at the time property is wrongfully acquired, not at the time the right to recover the trust is enforced by a court. *See, e.g.*, 5 Scott, *Trusts* § 462.4 (3d ed. 1967); *United States v. Fontana*, 528 F. Supp. 137 (S.D.N.Y. 1981). Moreover, it is not necessary that the parties intend to create a trust relationship in order for a constructive trust to arise. *See, e.g.*, 76 Am.Jur.2d *Trusts* § 221 (1975).[14]

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[14] The Tenth Circuit attempts to graft the intent requirement for resulting trusts onto constructive trusts. The case cited by the court as authority, *Blakey v. Brinson*, 286 U.S. 254, 261-62 (1932), involved an alleged resulting trust, not a constructive trust. Resulting trusts arise where title to property is transferred under circumstances which raise an inference that the person who makes the transfer does not *intend* the transferee to take a beneficial interest in the property. *Restatement (Second) of Trusts* § 1, Comment e; 5 Scott, *Trusts* § 462.1 (3d ed. 1967). Contrary to the

The Tenth Circuit's distortion of the nature of constructive trusts is a critical weakness of the court's decision. By beginning its analysis with the premise that constructive trusts are created only if intended by the parties and are otherwise merely post-insolvency remedies rather than vested pre-insolvency property rights, the court in effect assumes its ultimate conclusion from the outset. The rights of creditors are determined as of the date of the declaration of insolvency. The Tenth Circuit constructs a federal common law rule that the right to a constructive trust has not vested as of that date, absent the parties' intention to create a trust at the time of deposit. If no trust exists as of the declaration of insolvency, the funds subject to the trust instead become assets of the receivership. Thus, by definition the right to the trust property becomes a post-insolvency remedy that alters the distribution of the failed bank's assets in contravention to the National Bank Act.

This reasoning, if it were correct, would nullify every case allowing recovery of a constructive trust from a bank receiver. Every claim for constructive trust would necessarily effect a post-insolvency alteration in the rights of creditors and distribution of assets. Under the proper analysis, however, the Petitioners' constructive trusts arose at the moment Penn Square Bank fraudulently obtained their deposits. For that reason, the Petitioners' beneficial interests in the trust funds had vested as of the date of insolvency, and the receiver succeeded only to the rights and obligations of the bank as trustee. Because the funds were never actually assets belonging to Penn Square Bank, returning the funds to the Petitioners is consistent with the requirement that the failed bank's

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Tenth Circuit's characterization, a constructive trust arises irrespective of the intentions of the parties, in order to prevent unjust enrichment at the expense of the party whose property was wrongfully obtained. *See Healy v. Commissioner of Internal Revenue*, 345 U.S. 278, 283 (1953).

assets be ratably distributed. The Petitioners' funds are simply not part of those assets.

III. THE TENTH CIRCUIT'S DECISION WILL HAVE A GREAT ECONOMIC IMPACT ON UNINSURED DEPOSITORS IN FAILED BANKS AND THRIFTS.

The practical economic impact of the Tenth Circuit's decision is real and potentially enormous. In the last five years over 600 banks and 200 thrifts have failed and many more are expected to fail in the future.[15] Many of these have and will involve depositor payoffs similar to Penn Square Bank where uninsured depositors are exposed to losses. In absolute terms, uninsured deposits in federally insured banks at year-end 1988 totalled over $580 billion, the highest level in history. As a percentage of total deposits, uninsured deposits have risen since 1984; by the end of 1988 almost one out of every four dollars deposited in federally insured banks was uninsured.[16]

Clearly, bank failures with uninsured deposits of the magnitude of Penn Square Bank could occur again. Although after the Penn Square Bank failure in 1982 many large depositors sought to avoid risk by depositing only $100,000 in any single institution, many more uninsured depositors simply moved their deposits to larger banks based on the same questionable assumption that was re-

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[15] *See* Federal Deposit Insurance Corporation, *1988 Annual Report* at 72; Federal Home Loan Bank Board, *1987 Annual Report* at 11.

[16] According to the Federal Deposit Insurance Corporation, $580,509,000,000 in deposits in federally insured banks were above the $100,000 insurance limit on December 31, 1988. This amount comprised approximately 24.9 percent of all funds deposited in FDIC-insured banks. With the exception of 1987, uninsured deposits as a percentage of total deposits in FDIC-insured banks have risen every year since 1984. *See* Federal Deposit Insurance Corporation, *1988 Annual Report* at 74.

sponsible for attracting large amounts of uninsured deposits to Penn Square Bank, i.e., that the federal government will never liquidate large banks if they fail.[17] However, many predict that sooner or later another large bank will be liquidated. If that occurs, uninsured deposits of a similar magnitude to Penn Square Bank will again be subjected to loss.[18]

The Tenth Circuit's decision unfairly alters the allocation of risk among these uninsured depositors. Any large bank failure is likely to involve some element of fraud perpetrated against one or more uninsured depositors.[19] If the effect of such fraud is to increase the amount of cash on hand when the bank fails, other unsecured creditors, including the FDIC as subrogee of insured depositors who were paid off, benefit directly from the fraud when the fraudulently procured funds are distributed among such creditors rather than returned to the rightful owner. The Tenth Circuit's new standard ensures this inequitable result and potentially could result in the redistribution of millions of dollars to the other

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[17] According to a report by the FDIC, prior to the failure of Penn Square Bank in 1982, the FDIC's practice of providing de facto 100 percent deposit insurance for banks larger than $100 million had caused uninsured depositors to place funds in banks like Penn Square Bank which were larger than $100 million. *See supra* at 18-19. *See also* "FDIC Faulted for Redeeming Uninsured Deposits", *The American Banker*, Aug. 4, 1988, at 3, col. 2; "FDIC Drawing Fire on Policy of Saving Big Banks", *The Washington Post*, Apr. 2, 1988, at F1, col. 3.

[18] *See, e.g.*, "Seeds of a Crisis are Present in the Banking Industry", *The American Banker*, Oct. 11, 1989, at 5, col. 1; "FDIC Drawing Fire on Policy of Saving Big Banks", *The Washington Post*, Apr. 2, 1988, at F1, col. 3; Shaw, "Who's Insuring What for Whom: First Republic's Lessons", *The American Banker*, Apr. 8, 1988, at 4, col. 1.

[19] In 1987 the FDIC reported that fraud or insider abuse was a factor in one third of all bank failures. FDIC News Release PR-170-87 (Sept. 21, 1987).

creditors. Moreover, the likelihood of such a result can have an immediate effect on the investment behavior of uninsured depositors, even before a major bank failure.

The Tenth Circuit attempts to justify its preemption of state law property rights precisely because preemption of constructive trusts would have such a wide-ranging effect. Without citing any evidence, the court categorically concluded that allowing the Petitioners to recover would disrupt the orderly administration of the receiver's estate. It apparently believed that too many uninsured depositors would claim reliance on fraudulent financial statements, and that the FDIC would be "deluge[d] . . . with the potentially crushing weight of claims for preferences." 879 F.2d at 764 (Appendix A at 20a). The sheer difficulty and expense of proving fraud, augmentation, and tracing, however, is likely to discourage frivolous lawsuits. Moreover, such claims are no less entitled to relief than the many other claims against national bank receivers.

Rather than address the concern for orderly administration by wholesale elimination of state law rights for defrauded depositors as suggested by the Tenth Circuit, Congress has instead sought to increase the capacity of the FDIC to expeditiously administer a larger volume of claims through such mechanisms as alternative dispute resolution and binding arbitration. *See* The Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, § 212(a), 103 Stat. 183 (1989), *codified at* 12 U.S.C. § 1821(d)(4)-(10); *see also* H.R. Rep. No. 222, 101st Cong., 1st Sess. 502 (1989). The Tenth Circuit's attempt to judicially legislate changes in receivership administration is clearly inappropriate given the fact that Congress has so recently enacted comprehensive legislation to address the issue. The very fact that the Tenth Circuit felt compelled to do so only underscores the potential impact of its decision on the many receiverships and millions of dollars of uninsured deposits in bank failures across the nation.

Fundamentally, the error of the court below is its failure to protect state law rights in property, contrary to the mandate of Congress that only the assets of a failed national bank, not trust funds in possession of the bank's receiver, are subject to ratable distribution. In order to achieve the intended result, the Tenth Circuit has ignored established choice of law principles for determining the assets of the failed bank and created new federal common law rules which necessarily have the effect of abrogating the rights of constructive trust beneficiaries under state law. The end result is that the FDIC, as the largest creditor of Penn Square Bank, will reap the benefits of the fraud perpetrated upon the Petitioners. This Court in *Coit Independence Joint Venture v. FSLIC*, 489 U.S. ——, 109 S.Ct. ——, 103 L.Ed.2d 602 (1989), cited with approval the decision of the Ninth Circuit Court of Appeals in *Morrison-Knudson Co. v. CHG International, Inc.*, 811 F.2d 1209 (9th Cir. 1987), which addressed a similar attempt to formulate new federal common law to protect the thrift deposit insurance fund in the context of the thrift crisis:

> We respect FSLIC's desire to maintain its reserves and share its concern over the currently pressing problems in the thrift industry. Nonetheless, we must in this case obey statutes enacted before the difficulties that now confront FSLIC. We are not free to effect a wholesale revision of an agency's statutory authority in response to changed national conditions.

811 F.2d at 1216. The Tenth Circuit has attempted to address changed national conditions in the banking industry by judicially expanding the scope of assets included in the receivership estate of a national bank. The result is an increase in the recoveries for other creditors (such as the FDIC) and an erosion of state law authority in a manner never intended by Congress. Trust beneficiaries' pre-insolvency state law property rights can

only be protected if federal courts are required to uniformly apply state law to determine the pre-insolvency assets of failed banks.

CONCLUSION

WHEREFORE, Downriver Community Federal Credit Union and Wood Products Credit Union pray that a writ of certiorari issue from this Court to review the judgment of the Court of Appeals for the Tenth Circuit in this case. In the event that the petition is granted, Petitioners pray that the judgment of the court below be reversed, and that the cause be remanded with directions to affirm the judgment of the District Court for the Western District of Oklahoma.

Respectfully submitted,

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APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

Nos. 87-1648, 87-1649 and 87-1707

DOWNRIVER COMMUNITY FEDERAL CREDIT UNION,
Plaintiff-Appellant,

v.

PENN SQUARE BANK, through its Receiver,
FEDERAL DEPOSIT INSURANCE CORPORATION,
Defendant-Appellee,

WOOD PRODUCTS CREDIT UNION,
Plaintiff-Appellant/
Cross-Appellee,

v.

PENN SQUARE BANK, through its Receiver,
FEDERAL DEPOSIT INSURANCE CORPORATION,
Defendant-Appellee/
Cross-Appellant.

July 3, 1989

Thomas S. Dann, of Timothy D. Naegele & Associates, Washington, D.C., and Robert A. Wiener, of Weinberg, Zipser, Arbiter, Heller & Quinn, Los Angeles, Cal. (Timo-

thy D. Naegele, of Timothy D. Naegele & Associates, Washington, D.C., and C. Alexander Hewes, Jr., of Hewes, Morella, Gelband & Lamberton, Washington, D.C., with them, on the briefs), for plaintiffs-appellants.

Ann S. DuRoss (Donald B. McKinley, Regional Counsel, and Jane Rossowski, of Federal Deposit Ins. Corp., Washington, D.C., and Ronald N. Ricketts, of Gable & Gotwals, Tulsa, Okl., with her, on the briefs), Asst. Gen. Counsel, of Federal Deposit Ins. Corp., Washington, D.C., for defendant-appellee.

Before McKAY, and TACHA, Circuit Judges, and O'CONNOR, District Judge.*

TACHA, Circuit Judge.

This appeal arises from a dispute between certain uninsured depositors in the insolvent Penn Square Bank, N.A. (PSB), and the Federal Deposit Insurance Corporation (FDIC), in its capacity as receiver, over the priority of the depositors' claims against the insolvent bank's assets. The district court found that PSB fraudulently induced the plaintiffs to deposit funds through issuing financial statements that were materially misleading as to PSB's financial condition. In the remedy phase of the trial, the district court imposed a constructive trust upon PSB's assets in favor of the plaintiff-depositors, thereby entitling them to recover the full amount of their deposits, rather than their pro rata share under the relevant provision of the National Bank Act, 12 U.S.C. § 194. We hold that federal law limits these depositors' recovery to their pro rata share of the assets held by the receiver, and reverse.

I.

The plaintiffs, Downriver Community Federal Credit Union (Downriver) and Wood Products Credit Union (Wood Products), were among the 140 credit unions, 48

* The Honorable Earl E. O'Connor, Chief Judge, United States District Court for the District of Kansas, sitting by designation.

savings and loans, and 47 commercial banks holding substantial uninsured deposits in PSB when the Comptroller of the Currency ordered PSB closed on July 5, 1982. *See Penn Square Bank Failure: Hearings Before the House Comm. on Banking, Finance and Urban Affairs*, 97th Cong., 2d Sess., pt. 2, at 271 (1983). Like many other credit unions, Wood Products and Downriver had purchased certificates of deposit in PSB relying in part upon recommendations and financial information provided by money brokers, "the middlemen in the CD market whose fees were paid not by the credit unions, but by Penn Square." *Id.* at 267.

In December 1981 Downriver was solicited by First United Fund (FUF), a money broker located in Garden City, New York, that claimed to perform a "complete financial analysis" of all banking institutions that it represented. Downriver purchased its first PSB certificate of deposit on April 1, 1982, in reliance upon financial information that FUF provided over the telephone. FUF later provided Downriver with PSB's financial statements, prepared by PSB's accountants, Peat, Marwick, Mitchell & Co. (PMM), and Downriver purchased additional certificates of deposit in reliance upon the information contained therein. On the date that the Comptroller of the Currency closed PSB, Downriver held over $4 million in PSB certificates of deposit. The FDIC paid Downriver deposit insurance of $100,000 and issued a receiver's certificate for the uninsured balance of $3,938,240. As of December 10, 1986, Downriver had received dividend payments on that receiver's certificate totaling $2,166,031.42.

Wood Products similarly purchased a PSB certificate of deposit in reliance upon information provided by a money broker, Professional Asset Management, Inc. (PAM). PAM provided a list of financial institutions in which to invest and produced a "Capital Adequacy Report" reflecting the financial condition of each of those institutions. Financial information provided by the institutions that PAM represented formed the basis for those reports. Af-

ter analyzing the financial information contained in the report on PSB, Wood Products purchased a $500,000 PSB certificate of deposit on June 14, 1982. Upon PSB's closure, Wood Products received federal deposit insurance of $100,000 and a receiver's certificate covering the uninsured balance of $404,583.32. As of December 10, 1986, Wood Products had received dividends upon its receiver's certificate totaling $222,520.82.

As noted by the district court, the "calamitous event" of the closing of PSB generated many lawsuits against PSB, its officers, directors, and accountants, and the money brokers responsible for soliciting funds for the bank. Both Downriver and Wood Products commenced suits in the United States District Court for the Western District of Oklahoma, claiming in part that PSB knowingly or recklessly induced their deposits through issuing financial statements that materially mistated the the bank's financial condition. Those suits were consolidated with suits filed by several other parties who eventually settled during the trial, leaving only the claims of Downriver and Wood Products.

The case was tried in several phases, two of which are most relevant to this appeal. The first phase involved primarily the factual issue of whether PSB had fraudulently misrepresented its financial condition in its financial statements, and whether the plaintiffs had relied upon those misrepresentations in purchasing certificates of deposit in PSB. Downriver's claim was tried to the jury, and Wood Products' claim was tried to the court. In both cases, the trier of fact returned verdicts in favor of the plaintiffs, finding that PSB's December 31, 1981, and March 31, 1982, financial statements contained material misrepresentations; such misrepresentations were relied upon by the plaintiffs; and PSB's management and directors knew that those financial statements contained false or misleading information, or recklessly made those representations knowing that there was no reasonable ground for believing they were true.

The second phase of the trial involved remedy questions: whether a constructive trust could be imposed upon the assets held by the receiver, and, if so, whether such a constructive trust should include the post-insolvency interest that the receiver earned on the plaintiff's deposits.[1] The district court held that Oklahoma law, rather than federal law, governed whether a constructive trust could be imposed. Although the relevant provision of the National Bank Act, 12 U.S.C. § 194, requires ratable distribution among holders of receiver's certificates, the district court held that this provision did not "preclude identification and recovery of property that does not rightfully belong to the bank."

The district court found that the plaintiffs had satisfied the factual and legal prerequisites for imposition of a constructive trust under Oklahoma law: PSB had obtained the plaintiffs' deposits by fraud; such deposits had augmented PSB's assets; and the deposits could be traced into assets held by the receiver.[2]

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[1] Downriver had also asserted a claim for a constructive trust on the proceeds of one of its certificates of deposit that had matured on July 2, 1982, the last banking day on which PSB was open. Downriver's money broker, FUF, had issued wiring instructions to PSB to send the funds from the matured certificate to another bank, but the funds were not wired and remained in the bank on July 5, 1982, the date the Comptroller of the Currency closed PSB and appointed a receiver. The jury found that FUF was negligent in its attempt to have the funds wired, but rejected Downriver's allegation that PSB was guilty of fraud in failing to wire the funds. The court also rejected Downriver's theories that the proceeds constituted a segregated fund, and that PSB became its agent and breached a fiduciary duty in failing to transfer the funds. The district court therefore denied Downriver's plea for a constructive trust on the proceeds of the wire transfer. Downriver apparently does not appeal this aspect of the district court's decision.

[2] The district court found no Oklahoma cases discussing the augmentation and training requirements. The court noted, however, that because other jurisdictions imposed such requirements

The court also found that the imposition of a constructive trust would be equitable. First, the court noted that recovery by the plaintiffs would have only minimal impact upon the assets available to other uninsured depositors holding receiver's certificates. Second, the court noted that imposing a constructive trust in favor of the plaintiffs was not unfair to other uninsured depositors because other depositors could have brought similar claims on their own or intervened in the present case.

The district court therefore imposed a constructive trust on the assets held by the receiver to the extent of the principal amount of the deposits and interest accrued to the date of insolvency. The court denied the plaintiffs' claim for a constructive trust on the post-insolvency interest that the receiver earned on the plaintiffs' deposits, however, holding that federal law governed the distribution of interest accruing on a claim after insolvency of a national bank and that payment of interest on one claim while other claims remained unpaid in whole or in part would violate the requirement of ratable distribution of assets.

Although neither party challenges the district court's factual findings, both the plaintiffs and the FDIC contend that the court made legal errors. The plaintiffs contend that the district court erred in denying their claim for postinsolvency interest. The FDIC contends that the court erred in imposing a constructive trust for any amount of the plaintiffs' deposits, arguing that an imposition of a constructive trust in this case is a preference contrary to certain provisions of the National Bank Act, 12 U.S.C. §§ 91, 194. Because we agree with the FDIC that a constructive trust may not be imposed in this case,

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on parties seeking a constructive trust, *see, e.g., Converse Rubber Co. v. Boston-Continental Nat'l Bank*, 12 F.Supp. 887, 890 (D.Mass. 1935), *aff'd*, 87 F.2d 8 (1st Cir. 1936), Oklahoma could be expected to impose similar requirements.

we do not reach the question of whether an award of post-insolvency interest is permissible.

II.

Although an award of equitable relief is generally reviewed only for an abuse of discretion, *see McKinney v. Gannett Co.*, 817 F.2d 659, 670 (10th Cir.1987), we review de novo the district court's judgment when, as here, the availability of such equitable relief depends upon an interpretation of law, *see Pratte v. NLRB*, 683 F.2d 1038, 1040 (7th Cir.1982). In deciding the question of whether a constructive trust may be imposed in this case, the first issue to be resolved is the source of the applicable law.

Prior to the insolvency of a national bank, state law generally governs the nature of the relationship between a national bank and its depositors. *See Reno Nat'l Bank v. Seaborn*, 99 F.2d 482, 483 (9th Cir.1938).

> The creditor rights of a depositor of a national bank, by virtue of his loan to the bank and the effects of the conduct of the bank as altering such rights, are determined by the law of the state of the deposit, in the absence of a federal statute creating a different relationship. There is no underlying general federal law determining such rights (*Erie Ry. Co. v. Tompkins*, 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188, 114 A.L.R. 1487), and no federal statute denying to a cestui his right against a bank as its trustee, where, in the course of its business prior to the receivership, such a trust relationship has been created by the conduct of the bank.

Id. The parties' intention is critical in determining whether a relationship of debtor and creditor, or trustee and beneficiary, has been established by depositing funds in a national bank. *See Blakey v. Brinson*, 286 U.S. 254, 261-62, 52 S.Ct. 516, 517-18, 76 L.Ed. 1089 (1932).

State law governance of the preinsolvency contracts of national banks is limited, of course, by the paramount authority of Congress to regulate national banks.

> National banks are instrumentalities of the federal government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States. It follows that an attempt by a state to define their duties or control the conduct of their affairs is absolutely void, wherever such attempted exercise of authority expressly conflicts with the laws of the United States, and either frustrates the purpose of the national legislation or impairs the efficiency of these agencies of the federal government to discharge the duties for the performance of which they were created. These principles are axiomatic, and are sanctioned by the repeated adjudications of this court.

Davis v. Elmira Sav. Bank, 161 U.S. 275, 283, 16 S. Ct. 502, 503, 40 L.Ed. 700 (1896); *see id.* at 290, 16 S. Ct. at 506 ("general and undiscriminating state laws" govern contracts of national banks "so long as such laws do not conflict with the letter or the general objects and purposes of congressional legislation").

Although Congress has not enacted specific legislation to govern the preinsolvency relationship between national banks and their depositors, Congress has enacted legislation governing the distribution of assets upon the insolvency of a national bank. Most relevant here are provisions of the National Bank Act precluding payments by the bank that prefer some creditors over others, 12 U.S.C. § 91,[3] and requiring a ratable distribution of assets among

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[3] Section 91 provides in relevant part:

> All transfers of the notes, bonds, bills of exchange, or other evidences of debt owing to any national banking association, or of deposits to its credit; all assignments of mortgages, sureties on real estate, or of judgments or decrees in its favor;

all general creditors entitled to share in the receivership estate, 12 U.S.C. § 194.[4] As of the moment that a national bank is declared insolvent and goes into the hands of a receiver, federal law governs the distribution of the bank's assets. *See American Surety Co. v. Bethlehem Nat'l Bank*, 314 U.S. 314, 316-17, 62 S.Ct. 226, 227-28, 86 L.Ed. 241 (1941); *First Nat'l Bank v. Selden*, 120 F. 212, 215 (7th Cir.1903). All state laws inconsistent with the "system of equal distribution" established by the National Bank Act are preempted. *Jennings v. United States Fidelity & Guar. Co.*, 294 U.S. 216, 226, 55 S.Ct. 394, 398-99, 79 L.Ed. 869 (1935). "In no other way could there be unity of administration, and a carrying out of the federal mandate of equality." *Selden*, 120 F. at 215. As the Supreme Court has noted:

> all deposits of money, bullion, or other valuable thing for its use, or for the use of any of its shareholders or creditors; and all payments of money to either, made after the commission of an act of insolvency, or in contemplation thereof, made with a view to prevent the application of its assets in the manner prescribed by this chapter, or with a view to the preference of one creditor to another, except in payment of its circulating notes, shall be utterly null and void . . . .
>
> 12 U.S.C. § 91.

[4] Section 194 provides:

> From time to time, after full provision has been first made for refunding to the United States any deficiency in redeeming the notes of such association, the comptroller shall make a *ratable dividend* of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and, as the proceeds of the assets of such association are paid over to him, shall make further dividends on all claims previously proved or adjudicated; and the remainder of the proceeds, if any, shall be paid over to the shareholders of such association, or their legal representatives, in proportion to the stock by them respectively held.
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> 12 U.S.C. § 194 (emphasis added).

> We consider [the National Bank Act] as constituting by itself a complete system for the establishment and government of national banks, prescribing the manner in which they may be formed . . . and the manner . . . in which their affairs shall be wound up, their circulating notes redeemed, and other debts paid, or their property applied toward such payment.

Cook County Nat'l Bank v. United States, 107 U.S. 445, 448, 2 S.Ct. 561, 564, 27 L.Ed. 537 (1883).

When, as here, the FDIC is involved in its capacity as receiver, we must also read the National Bank Act in conjunction with the Federal Deposit Insurance Act. *FDIC v. McKnight*, 769 F.2d 658, 662 (10th Cir.1985), *cert. denied*, 475 U.S. 1010, 106 S.Ct. 1184, 89 L.Ed.2d 300 (1986). The FDIC is empowered by statute "[t]o sue and be sued." 12 U.S.C. § 1819 (Fourth). The statute further provides that "[a]ll suits of a civil nature at common law or in equity to which the [FDIC] shall be a party shall be deemed to arise under the laws of the United States." *Id.*;[5] *see D'Oench, Duhme & Co. v. FDIC*, 315 U.S. 447, 467-68, 62 S.Ct. 676, 683-84, 86 L.Ed. 956 (1942) (Jackson, J., concurring); *FDIC v. Braemoor Assocs.*, 686 F.2d 550, 553 (7th Cir.1982), *cert. denied*, 461 U.S. 927, 103 S.Ct. 2086, 77 L.Ed.2d 297 (1983). Upon the insolvency of a national bank and the appointment of the FDIC as receiver, therefore, it is well settled that all claims against the receiver's estate are governed by federal law. *See, e.g., FDIC v. Bank of San Francisco*, 817 F.2d 1395, 1398 (9th Cir. 1987); *FDIC v. Palermo*, 815 F.2d 1329, 1334 (10th Cir.1987); *Interfirst Bank Abilene, N.A. v. FDIC*, 777 F.2d 1092, 1094

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[5] Section 1819 creates an exception to this provision for "any . . . suit to which [FDIC] is a party in its capacity as receiver of a *State* bank and which involves only the rights or obligations of depositors, creditors, stockholders, and such State banks under State law." 12 U.S.C. § 1819 (Fourth) (emphasis added). That exception is not this case.

(5th Cir.1985); *McKnight*, 769 F.2d at 661; *Selden*, 120 F. at 215.

The plaintiffs attempt to avoid the application of federal law to their claim, however, on the ground that their equitable right to the funds arose prior to insolvency. They contend that Oklahoma law governs the nature of their preinsolvency relationship with PSB, and that, because of PSB's fraud, their deposits never became part of PSB's assets, but were instead impressed with a trust relating back to the date of their initial deposits. The equitable fiction of the trusts relating back to the date that the plaintiffs deposited funds in PSB, however, does not change the fact that by purchasing a certificate of deposit in PSB, the plaintiffs intended a debtor and creditor relationship. *See Atlantic Gypsum Co. v. Federal Nat'l Bank*, 76 F.2d 59, 60 (1st Cir.1935) ("Deposits with national banks, evidenced by a certificate of deposit, are ordinarily made on the credit of the bank, and create only a debtor and creditor relation.") Although the state law of contracts governs whether the parties intended to form a trust or a debtor/creditor relationship prior to insolvency, any attempt to recharacterize that relationship equitably after insolvency is governed by federal law.[6]

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[6] The plaintiffs rely upon *Reno Nat'l Bank v. Seaborn*, 99 F.2d 482 (9th Cir. 1938), for the proposition that state law determines whether a trust relationship arose prior to insolvency. In *Seaborn*, the Ninth Circuit considered whether the conduct of a national bank prior to insolvency converted the plaintiff's deposit into a trust fund. *Id.* at 483. The plaintiff, the receiver of a failed state bank, sought to establish that its deposit in a national bank was transformed into a trust fund when the national bank promised to transfer the receiver's funds to another state bank, but failed to do so prior to becoming insolvent. *Id.* at 482-83. The question before the court concerned the legal effect of an instruction to transfer funds, and the court held that state law governed this question. *Id.* at 483. "No need of federal uniformity exists requiring that federal banks in each state shall conduct their ordinary banking business exactly as in every other state." *Id.* After ex-

The FDIC, as receiver, takes control of an insolvent national bank subject to the "rights and equities" existing prior to insolvency. *Palermo*, 815 F.2d at 1334. The relevant provisions of the National Bank Act admittedly do not provide explicit guidance for the disposition of all claims against the receiver's estate. *See D'Oench, Duhme & Co.*, 315 U.S. at 470, 62 S.Ct. at 685. (Jackson, J., concurring) (noting "recognized futility of attempting all-complete statutory codes"). "Congress has seen fit not to anticipate by specific rules solution of problems that inevitably arise in national bank liquidations." *Bethlehem Nat'l Bank*, 314 U.S. at 316, 62 S.Ct. at 228. "Instead, [Congress] chose achievement of a 'just and equal distribution' of an insolvent bank's assets through the operation of familiar equitable doctrines evolved by the courts." *Id.* (quoting *Elmira Sav. Bank*, 161 U.S. at 284, 16 S.Ct. at 504). Federal common law governs the application of such equitable doctrines. *See FDIC v. Mademoiselle of Cal.*, 379 F.2d 660, 662-63 (9th Cir. 1967).

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amining the plaintiff's instruction to transfers the funds, and the bank's agreement to do so, the court concluded that no trust had been established. *Id.* at 484. The plaintiff's credit balance at the bank was not segregated into a separate fund and was still subject to the receiver's check. *Id.* The debtor and creditor relationship was still intact, and no trust had been established by the plaintiff's order. *See id.* Instead of full recovery, the plaintiff merely had a claim to a pro rata share in the distribution of the national bank's assets. *See id.* at 483.

To the extent that *Seaborn* is interpreted to have applied state law to determine whether the parties intended a trust to be formed, or whether the bank created a trust by segregating the plaintiff's funds, it is consistent with our analysis. To the extent that *Seaborn* may be interpreted as support for the position that equitable claims against the receiver's estate are governed only by state law, we disagree. As discussed more fully in part III of this opinion, we may choose to adopt state law as the rule of decision, but we need not do so when a conflict with the purposes of the National Bank Act would result.

III.

Having decided that federal common law governs the plaintiffs' claims does not necessarily preclude the application of Oklahoma law allowing a constructive trust remedy. "In fashioning the federal common law in this area we may look for guidance to the law of the state having the closest connection to the transaction at issue when to do so would not conflict with the need for uniform rules governing bank liquidations." *Palermo*, 815 F.2d at 1334.

When a "federal policy or need for uniformity" would be "frustrated" by the application of state law as the federal rule of decision, *Palermo*, 815 F.2d at 1334-35, however, we must devise from sources other than state law our own principles that conform with that policy or need. *See id.; see also Bank of San Francisco*, 817 F.2d at 1398 (noting that federal court making " 'specialized federal common law' " may "adopt the law of the state involved" or "draw on the federal law merchant" (quoting Friendly, *In Praise of* Erie—*And of the New Federal Common Law*, 39 N.Y.U.L. Rev. 383, 406 (1964))); *Braemoor Assocs.*, 686 F.2d at 554 (suggesting that "in an appropriate case a federal court could reject state substantive law if . . . necessary to protect the FDIC's interest in minimizing depositor losses"). As Justice Jackson stated:

> A federal court sitting in a non-diversity case such as this does not sit as a local tribunal. In some cases it may see fit for special reasons to give the law of a particular state highly persuasive or even controlling effect, but in the last analysis its decision turns upon the law of the United States, not that of any state. Federal law is no juridical chameleon, changing complexion to match that of each state wherein lawsuits happen to be commenced because of the accidents of service of process and of the application of the venue statutes. It is found in the federal Constitution, stat-

> utes, or common law. Federal common law implements the federal Constitution and statutes, and is conditioned by them. Within these limits, federal courts are free to apply the traditional common-law technique of decision and to draw upon all the sources of the common law. . . .
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> . . . [The substantive issue here] is not a question to be answered from considerations of geography. That a particular state happened to have the greatest connection in the conflict of laws sense with [the activity forming the basis of the claim] is not enough to make us subservient to the legislative policy or the judicial views of that state.

D'Oench, Duhme & Co., 315 U.S. at 471-73, 62 S.Ct. at 686-87 (Jackson, J., concurring) (footnote omitted); *cf. Silkwood* v. *Kerr-McGee Corp.*, 464 U.S. 238, 248, 104 S.Ct. 615, 621, 78 L.Ed.2d 443 (1984) (noting preemption of state law when "the state law stands as an obstacle to the accomplishment of the full purposes and objectives of Congress").

Here, we must utilize governing principles that are in conformity with the policies underlying the National Bank Act. *See Palermo*, 815 F.2d at 1334. Most important to this case are the policies of achieving the "equity of equality among creditors," *Scott v. Armstrong*, 146 U.S. 499, 511, 13 S.Ct. 148, 152, 36 L.Ed. 1059 (1892), and of the orderly liquidation of the receiver's estate, *see Bryant v. Linn County, Or.*, 27 F.Supp. 562, 565 (D.Or. 1938), that are implicit in 12 U.S.C. §§ 91, 194.

Congress chose to achieve, through the National Bank Act, "a just and equal distribution of the assets of national banks among all unsecured creditors." *Elmira Sav. Bank*, 161 U.S. at 284, 16 S.Ct. at 504. "This public aim in favor of all the citizens of every state of the Union is manifested by the entire context of the national bank act." *Id.* "The FDIC, when acting as a receiver for an

insolvent bank, cannot prefer some creditors over others; rather, all creditors must share in a ratable distribution of the insolvent bank's assets." *Hibernia Nat'l Bank v. FDIC*, 733 F.2d 1403, 1407 (10th Cir.1984). The receiver is charged with the duty of "securing equal justice to all its creditors . . . under a law which sternly forbids preferences." *Casey v. Cavaroc*, 96 U.S. 467, 489, 24 L.Ed. 779 (1878). The National Bank Act is "distinctly unfriendly to the recognition of special interests or preferred claims. Doubts should be resolved against them." *Atlantic Gypsum*, 76 F.2d at 61 (citations omitted).

The Act's unfriendliness to special interests requires a claimant seeking a preference from pro rata distribution of assets to bear a heavy burden of proof. *See Hibernia Nat'l Bank*, 733 F.2d at 1408; *see also Bryant*, 27 F. Supp. at 565 ("[a]s a matter of orderly liquidation in accordance with [the Act]" federal courts uniformly put burden on claimant seeking preference based on trust arising *ex maleficio*). A national bank's fraudulent conduct may give rise to a constructive trust only when the plaintiff can show that the bank's fraud caused a particular harm that is not shared by substantially all other depositors, and that granting relief to the plaintiff does not disrupt the orderly administration of the receiver's estate. This general rule is exemplified in the cases involving constructive trusts imposed upon the assets of a hopelessly insolvent bank.

A bank receiving deposits after its officers know that the bank is hopelessly insolvent is deemed to commit fraud upon those depositors, entitling them to reclaim their deposits.[7] *See, e.g., St. Louis & S.F. Ry. v. Johnston*, 133

[7] As in other cases involving the recovery of a trust fund, the right to reclaim a deposit is contingent upon the plaintiff's proof that the deposit augmented the receiver's estate and can be traced into the possession of the receiver. *See Queenan v. Mays*, 90 F.2d 525, 531-32 (10th Cir.), *cert. denied*, 302 U.S. 724, 58 S.Ct. 45, 82 L.Ed. 559 (1937); *Flynn v. Smith*, 90 F.2d 305, 310-11 (7th Cir. 1937); *Kershaw v. Jenkins*, 71 F.2d 647, 649 (10th Cir. 1934).

U.S. 566, 576-77, 10 S.Ct. 390, 392-93, 33 L.Ed. 683 (1890); *Carnegie-Illinois Steel Corp. v. Berger*, 105 F.2d 485, 487 (3d Cir.), *cert. denied*, 308 U.S. 603, 60 S.Ct. 140, 84 L.Ed. 504 (1939); *Standard Oil Co. v. Elliott*, 80 F.2d 158, 161 (4th Cir.1935); *Federal Reserve Bank v. Omaha Nat'l Bank*, 45 F.2d 511, 519 (8th Cir.1930), *cert. denied*, 282 U.S. 902, 51 S.Ct. 215, 75 L.Ed. 794 (1931). This right to reclaim is restricted to claimants who deposited funds *after* the date the bank is known by its officers to be hopelessly insolvent, and it extends only to "the sum paid in" at such time. *Berger*, 105 F.2d at 487. "[M]ere embarrassed circumstances, or even simple insolvency of a bank at the time of receiving a deposit, without more, does not warrant the rescission, for fraud, of the contract of deposit, if, when the deposit was accepted, there was a present genuine and reasonably founded hope, expectation, and intention on the part of the bank's officers to carry on the business." *Byrd v. Ross*, 58 F.2d 377, 378 (S.D.Fla.1932). If the bank's officers have "ground for the supposition that the bank might continue in business," *Johnston*, 133 U.S. at 578, 10 S.Ct. at 393, and merely omit to disclose the precarious financial condition of the bank, a constructive trust is not available. *See id.*

Those who deposit funds after a bank is hopelessly insolvent can show a specific act of fraud that affects only them, and therefore they have a superior equitable position over others who deposited funds prior to hopeless insolvency with a hope or belief in the bank's future ability to repay the deposit. Furthermore, a hopelessly insolvent bank should have been closed by the Comptroller of the Currency as of the date of such insolvency, thereby preventing the receipt of further deposits. Equity therefore "regards that as done which should have been done," *O'Neal v. White*, 79 F.2d 835, 835 (4th Cir.1935), *cert. denied*, 297 U.S. 706, 56 S.Ct. 501, 80 L.Ed. 994 (1936), and permits the rescission of deposit contracts made after the bank should have been closed.

Even in the case of hopeless insolvency, however, full restitution may be denied when it would sufficiently disrupt the orderly administration of the receiver's estate or otherwise result in inequitable treatment to other similarly situated depositors. *See Bryant*, 27 F.Supp. at 565. In *Bryant*, the court refused a claim for a constructive trust by a party which had deposited funds in a national bank that had been insolvent "for many years." *Id.* at 563. That party, as well as many other depositors who were not parties to the suit, had made such deposits "upon the faith of the solvency of the Bank." *Id.* Because the complaining party did not "assert the claim of trust ex maleficio until almost twenty-three months after the closing of the Bank," and because virtually all other depositors could have been considered in the same situation due to the unusual length of time that the bank was hopelessly insolvent, the court denied a constructive trust. *See id.* at 565-66; *see also Berger*, 105 F.2d at 487-88 (denying constructive trust due to delay in bringing claim when allowing claim "would work havoc in the orderly administration" of bank's affairs); *Leonard v. Gage*, 94 F.2d 19, 25-26 (4th Cir.), *cert. denied*, 303 U.S. 653, 58 S.Ct. 752, 82 L.Ed. 1113 (1938) (allowing recovery in favor of receivers of national banks against receivers of state bank when relief could be awarded "without disrupting in any way the orderly administration of the estate or prejudicing the just rights of any of the creditors"); *Poole v. Elliott*, 76 F.2d 772, 774-75 (4th Cir.1935) (denying constructive trust upon assets of insolvent state bank when claim "would affect a large part of the obligations to depositors and probably all of the cash assets passing into the hands of the receivers" and cause "injustice to other persons interested in the administration of the estate").

Here, the application of these policies—preserving the orderly administration of the receiver's estate and achieving an equitable distribution among creditors—is not a

question to be decided fortuitously because "a particular state happened to have the greatest connection in the conflict of laws sense." *D'Oench, Duhme & Co.*, 315 U.S. at 473, 62 S.Ct. at 687 (Jackson, J., concurring). We refuse here to adopt Oklahoma law as the federal rule of decision because to do so would permit a constructive trust in favor of plaintiffs in contravention of the principles implicit in the National Bank Act.

In awarding a constructive trust in favor of the plaintiffs, the district court relied upon an Oklahoma statute providing that:

> [o]ne who practices a deceit with intent to defraud the public, or a particular class of persons, is deemed to have intended to defraud every individual in that class, who is actually misled by the deceit.

Okla.Stat.Ann. tit. 76, § 4 (West 1987). The plaintiffs, having proved reliance upon PSB's published financial statements, were deemed to have been "actually misled" by PSB at the time they purchased PSB certificates of deposit, and accordingly the trial court ordered that they be allowed to recover all of their deposits. Such recovery violates both of the federal policies implicit in the National Bank Act.

Permitting recovery to the plaintiffs because they could prove reliance upon the financial statements, to the detriment of other uninsured depositors who could not or did not come forward to prove reliance upon PSB financial statements, fails to accord equal treatment to PSB creditors. PSB's deceptive acts could not have reached only the plaintiffs. A congressional committee investigating the failure of PSB found that many financial institutions similarly relied upon financial statements representing PSB's financial integrity.

> Through the final months of Penn Square's existence, and even up to the last day before the bank's doors were closed, in fact, just hours before the doors

> were closed, many small financial institutions were placing funds in this shopping center bank, reassured by a Peat, Marwick, Mitchell & Co. audit that some have said gave the bank a "clean bill of health."
>
> So healthy did some find it that they put in sums well above the insured amounts—in many cases running into the millions of dollars from individual institutions. All told, credit unions alone lost $111 million in uninsured funds in Penn Square—over 20 percent of the bank's deposits when it failed.

Penn Square Bank Failure: Hearings Before the House Comm. on Banking, Finance and Urban Affairs, 97th Cong., 2d Sess., pt. 2, at 267 (1983) (statement of Rep. St. Germain, committee chairman).

Whether independently analyzing PSB financial statements, or relying upon money brokers who analyzed PSB's financial condition based upon the information contained in those statements, financial institutions other than the plaintiffs undoubtedly placed similar trust in PSB's misrepresented financial condition in assessing their risk of future loss.[8] *See id.* at 271. The National Bank Act pre-

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[8] The plaintiffs argue that no other financial institutions relied upon PSB financial statements in depositing uninsured funds in PSB because, as noted in a report prepared by the FDIC, "[s]ince 1960 about three-fourths of all failed commercial banks and, *until Penn Square Bank*, all failures over $100 million in size have been handled through purchase and assumption transactions (P & As)." FDIC, *Deposit Insurance in a Changing Environment* ch. I, at 6 (1983) (report submitted to Congress pursuant to § 712 of the Garn-St. Germain Depository Institution Act of 1982). "In P & As all deposits (including uninsured deposits) and other liabilities of general creditors are assumed by a new or existing bank. Thus, despite a bank failure, all depositors and other general creditors are made whole in a P & A." *Id.; see id.* ch. III, at 4. According to the FDIC report, the widespread use of P & A transactions, instead of merely paying off uninsured depositors their pro rata share of the bank's assets, has altered public perceptions of the safety of funds. *Id.* ch. III, at 1. "[T]his growing perception of almost

cludes these depositors from being treated differently. *Cf. Beacon Mfg. Co. v. Hood*, 204 N.C. 349, 168 S.E. 523, 524 (1933) (reaching identical result under state law in denying depositor's claim for preference in state bank assets). "[I]t is clear that other depositors as to deposits made during this period are entitled in equity to the same relief as [the party seeking a constructive trust], and in granting relief the court should see that their rights are protected." *Standard Oil Co.*, 80 F.2d at 161. "In the absence of a false and fraudulent representation made specifically to the plaintiff, with respect to the financial condition of the [bank], the plaintiff has no equity superior to the rights of other depositors or creditors of the [bank], who made deposits in said [bank] in reliance upon the statements published by said [bank]. . . ." *Beacon Mfg.* 168 S.E. at 524.

Although the plaintiffs contend that we might avoid this unequal treatment by permitting all depositors situated similarly to the plaintiffs to sue as a class to establish constructive trusts, to allow such suits would potentially jeopardize the orderly administration of the receiver's estate that is required by the Act. We do not think that Congress would have intended to deluge the FDIC with the potentially crushing weight of claims for preferences on behalf of all the uninsured depositors who could allege that they relied upon misleading information that was available to all depositors. Allowing such a pref-

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absolute safety of funds in large institutions is having the effect of removing the consideration of bank risk from business decisions." *Id.*

The fact that risk considerations may have been reduced at that time due to the historical pattern of FDIC practices does not mean that risk of failure was completely excluded from the market. The fact that both of the plaintiffs utilized the services of money brokers, who performed some degree of financial analysis on the institutions they represented, and who were responsible for soliciting the deposits of numerous other institutions, clearly shows that the market was not blind to the risk of failure.

erence to be based upon a "race of diligence" among creditors would make "the equality promised to them by the [National Bank Act] . . . a mere mockery." *First Nat'l Bank v. Colby*, 88 U.S. (21 Wall.) 609, 614, 22 L.Ed. 687 (1875). Any remedy for fraudulent representations that affects, or potentially affects, all creditors belongs to the receiver, who asserts such claims for the benefit of all creditors. *Cf. In re Longhorn Sec. Litig.*, 573 F.Supp. 255, 272 (W.D.Okla.1983) (noting "general rule" that "wrongs committed by a bank's officers or directors that injure all depositors and creditors alike create a liability which is an asset of the bank itself and for which only the bank or its receiver may recover"). When all creditors have been similarly harmed, pro rata distribution of the assets in accordance with the mandate of the National Bank Act accomplishes the same result as if all uninsured depositors had brought suit on their own behalf. *Bryant*, 27 F.Supp. at 565.

Accordingly, the order of the district court imposing a constructive trust upon the assets of PSB in favor of the plaintiffs is REVERSED.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF OKLAHOMA

No. CIV-82-1357-A

Consolidated with:

No. CIV-83-69-A
No. CIV-83-1583-A
No. CIV-83-3117-A
No. CIV-84-1596-A
No. CIV-84-1612-A
No. CIV-84-1663-A
No. CIV-84-1671-A
No. CIV-84-1672-A

PROFESSIONAL ASSET MANAGEMENT, INC.,
a California corporation,
Plaintiff,

v.

PENN SQUARE BANK, N.A., *et al.*,
Defendants.

ORDER

[Filed Dec. 15, 1986]

On July 5, 1982, the Office of the Comptroller of the Currency ("OCC") closed Penn Square Bank ("PSB") and appointed the Federal Deposit Insurance Corporation ("FDIC") as its receiver. That calamitous event was the genesis of numerous lawsuits including the nine cases that were consolidated for trial before this Court. The trial of the Penn Square consolidated cases com-

menced on August 19, 1986. Several parties settled their cases after the trial began; thus this order addresses only the claims of the remaining plaintiffs, Downriver Community Federal Credit Union and Wood Products Federal Credit Union. Wood Products and the FDIC had opted for a trial to the Court while Downriver sought a jury trial. At the conclusion of Phase I of the trial, the Court entered a verdict for Wood Products and the jury entered a verdict for Downriver against the FDIC as receiver for fraud committed by PSB. Wood Products [1] and Downriver sought a constructive trust on their funds that were in PSB when it was closed. The first part of this Order contains the Court's findings of facts and conclusions of law on Wood Products' fraud claim against the FDIC; the second part addresses the constructive trust issue.

I.

WOOD PRODUCTS' FRAUD CLAIM— FINDINGS OF FACT AND CONCLUSIONS OF LAW

After considering the evidence presented, the applicable legal authority and the statements of counsel, the Court enters the following findings of fact and conclusions of law.

Findings of Fact:

1. Wood Products Credit Union ("Wood Products") is a non-profit, state chartered credit union in Oregon. Its principal place of business is in Springfield, Oregon.

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[1] The Court notes that it denied Wood Products' motion to amend its Complaint to add the constructive trust theory on January 30, 1986. Federal Rule of Civil Procedure 54(c) provides "Except as to a party against whom a judgment is entered in default, every final judgment shall grant the relief to which the party in whose favor it is rendered is entitled, even if the party has not demanded such relief in his pleadings." Wood Products' requested amendment would have served no purpose not served by Rule 54(c) itself.

Wood Products' approximately 35,000 members are principally employed in the wood products industries in Oregon.

2. Penn Square Bank, N.A. ("PSB") was chartered as a national banking association by the Office of the Comptroller of the Currency ("OCC") on November 4, 1959.

3. The Defendant, FDIC, is a party to this action as Receiver of PSB.

4. This case arises from Wood Products' Complaint against the PSB/FDIC. Wood Products alleges fraud on the part of PSB, by its officers and directors; and additionally, alleges constructive fraud [2] against PSB by its officers and directors.

5. Both Wood Products' fraud and constructive fraud claims arise from the financial statements published and disseminated as of December 31, 1981 and the Statement of Condition for Penn Square Bank as of March 31, 1982. Wood Products alleges the 12/31/81 financial statements and 3/31/82 Statement of Condition were materially false and misleading.

6. Professional Asset Management ("PAM"), a money broker, distributed to Wood Products its Capital Adequacy Reports that contained financial information from banks. Wood Products could call PAM to obtain the interest rates offered by banks listed in the Capital Adequacy Report. The financial information included assets, net worth and net income from which, in PAM's opinion, the most im-

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[2] Wood Products' constructive fraud claim was not actively pursued in this litigation. The Court is, therefore, not sufficiently informed to discuss constructive fraud as an alternative basis for recovery. The Court believes that if the appellate court rules the fraud verdict here is not sufficient to support a constructive trust theory of recovery, then the appellate court would very likely not consider constructive fraud as an adequate basis for recovery.

portant operating ratios could be ascertained, e.g., equity to assets.

7. Wood Products understood that PAM selected a group of banks and savings and loans that appeared to be sound and adequately capitalized.

8. Wood Products first purchased a certificate of deposit utilizing PAM's services at the end of 1981.

9. Wood Products decided to buy a PSB certificate of deposit based on PAM's listing of PSB in the Capital Adequacy Report as well as Wood Products' own review and analysis of the Capital Adequacy Report.

10. Wood Products purchased a PSB certificate of deposit in the amount of $500,000 with a ninety-one day term on June 14, 1982.

11. On July 5, 1982 PSB was closed by the Office of the Comptroller of the Currency ("OCC") and the FDIC was appointed Receiver of PSB.

12. Following the closing of PSB, Wood Products applied for and received two receiver's certificates for the uninsured portion of its PSB certificate of deposit.

13. Thereafter, Wood Products accepted dividend payments under the receiver's certificate.

14. The OCC was required by federal statute to supervise and examine PSB.

15. The OCC had the statutory authority to, and on September 9, 1980 did require PSB and its Board of Directors to enter into a written Administrative Agreement with the OCC, which agreement is a "written agreement entered into with the agency" within the meaning of 12 U.S.C. § 1818(b)(1).

16. Pursuant to 12 U.S.C. § 1818(c)(1), the OCC had the authority to and on June 30, 1982 did issue a Temporary Order to Cease and Desist against PSB, its officers, directors, employees and agents.

17. Pursuant to 12 U.S.C. § 1818(b)(1), the OCC had the authority to and on June 30, 1982 did issue a Notice of Charges against PSB, its officers, directors, employees and agents, which Notice of Charges was set for hearing in the U.S. Courthouse for the Western District of Oklahome at 10:00 a.m. on August 30, 1982.

18. Pursuant to 12 U.S.C. § 1818(c)(1), the OCC had the authority to and did determine that the violations or threatened violations of law, rule and regulation, or the unsafe or unsound practices, specified in the Notice of Charges or the continuation thereof, were likely to cause insolvency or substantial dissipation of the assets or earnings of PSB, or were likely to seriously weaken the condition of the Bank or otherwise seriously prejudice the interests of the Bank's depositors.

19. Under 12 U.S.C. 1818(b)(1), the OCC found that those violations of law, rule, regulation and/or written conditions of the OCC, and the unsafe and unsound banking practices specified in the notice of charges which PSB and its officers, directors, employees and agents engaged in, were established.

20. In violation of Article IV of the Administrative Agreement and contrary to safe and sound banking practices, PSB failed to obtain and maintain current and satisfactory credit information on a significant volume of its extensions of credit.

21. In violation of Article IV of the Agreement and contrary to safe and sound banking practices, PSB granted credit in significant amounts which were not fully supported by all necessary collateral documentation.

22. In violation of Article V of the Agreement, PSB extended additional credit to borrowers whose loans were previously criticized (by the OCC) without first placing in the credit file of the borrower and forwarding to the Regional Administrator of National Banks for the Eleventh National Bank Region, Dallas, Texas (hereinafter

"Regional Administrator") a statement, signed by the majority of the Bank's directors, detailing why failure to make additional extensions of credit would be detrimental to the interests of PSB.

23. In violation of Article IX of the Agreement and contrary to safe and sound banking practices, the Officers and Directors recklessly failed to maintain a loan loss reserve at realistic and adequate levels commensurate with the risks and losses that were inherent in PSB's recklessly mismanaged loan portfolio and thus caused or recklessly permitted PSB's income and shareholder equity to be grossly overstated. Due in part to the significant determination in the quality of PSB's loan portfolio, as revealed by OCC's examination of PSB at December 31, 1979, the Administrative Agreement dated September 9, 1980 required PSB to conduct a review of its Allowance for Possible Loan Losses on at least a quarterly basis to ensure its maintenance at adequate levels commensurate with the risks and potential losses inherent in PSB's loan portfolio. The OCC's general supervisory examination of PSB at December 31, 1980 revealed, however, that PSB still lacked an internal loan review program and was unable to produce any meaningful list of its problem loans; that PSB's management had completely failed to make any significant analysis of the various factors that were required to be analyzed in order for PSB to maintain an adequate and realistic loan loss reserve; and that PSB's loan loss reserve was based upon an arbitrary percentage (1%) of PSB's outstanding loans. Thus, PSB's method of determining the adequacy of its loan loss reserve was criticized as being inadequate and unacceptable, and a requirement was made that PSB's loan loss reserve analysis be expanded to include an assessment of past-due loans, changes in loan mix, changes in the economy, and an in-depth review of potential weaknesses and losses in individual loans and in PSB's loan portfolio as a whole. Such review and analysis was to be performed on a continuing basis, was to be well and fully documented, and

was to be approved by PSB's Board of Directors. Likewise, in its management letter to PSB's Board of Directors, dated May 20, 1981, Arthur Young & Company pointed out that PSB's loan loss reserve was being calculated on the basis of a fixed and arbitrary percentage of PSB's total loans outstanding, and Arthur Young & Company recommended that to properly monitor the loan portfolio and related reserve for loan losses "a more definitive policy should be implemented to provide for review of individual loans or lines of credit." Despite the requirements of the Administrative Agreement and the subsequent criticisms of PSB's inadequate loan loss review analysis, PSB's substantive loan review activities did not begin to function until August of 1981, almost one year after the date of the Administrative Agreement. From that time until PSB was declared insolvent on July 5, 1982, PSB's loan review activities were largely restricted to a review of loans that had been previously criticized by the OCC and to efforts to identify problem loans in the non-oil and gas portions of PSB's loan portfolio. Thus, oil and gas related loans, which comprised roughly 80% of PSB's total loan portfolio and which represented the more complicated and higher risk loans, were never substantially reviewed or evaluated by PSB's loan review committee for the purpose of determining and establishing an adequate loan loss reserve. As a result, PSB's loan loss reserve as of December 31, 1981 was grossly understated, and conversely, PSB's pre-tax income and shareholder equity as reflected in the December 31, 1981 financial statements and in subsequent statements of condition were grossly overstated.

24. Contrary to safe and sound practices, PSB, on loans it originated on which it had subsequently sold participations, paid interest to participating institutions on behalf of the borrower without advising the participating institution PSB was advancing funds for said payments. These habitual advances of uncollected and uncollectable

principle and interest payments (called "upstreamed interest"), which were made for the purpose of appeasing the participating banks who otherwise threatened to stop purchasing loan participations from PSB, were unsafe, unsound and imprudent for the following reasons, among others:

A. They caused a continual and substantial increase in PSB's non-earning assets and thereby substantially reduced PSB's potential earnings.

B. They amounted to unapproved and imprudent extensions of credit to borrowers who were not creditworthy and who had already demonstrated their inability to repay existing obligations.

C. They substantially increased the volume of PSB's loan losses beyond that which was inherent in PSB's otherwise risky and recklessly mismanaged loan portfolio.

Minutes from the Asset and Liability Committee meetings show that Mr. Beller, who was the president and chief administrative officer of PSB, was aware of the upstreaming of interest in December, 1981.

25. The officers and directors caused or recklessly permitted PSB to repeatedly repurchase uncollectable loans that PSB had previously participated to various upstream and downstream correspondent banks, despite the fact that the participation agreements pertaining to such loans did not obligate PSB to make such repurchases, thereby causing PSB to incur heavy losses resulting from such bad loans. These repurchases of bad loans were made for the purpose of maintaining participant banks as a ready source for sales of other loan participations, often with the knowledge of and/or at demand of such participant banks as the price of maintaining the merchant banking relationship.

26. Contrary to safe and sound practices and in violation of Article VI of the Agreement, PSB failed to im-

plement and adhere to procedures to limit, control and document contingent liabilities on unfunded loan commitments and letters of credit.

27. The officers and directors caused PSB to make, or recklessly permitted PSB to make, excessive loans to the officers and directors and their related entities without regard to the creditworthiness of the borrower, without proper credit information or documentation, and often upon preferential terms and in amounts that constituted violations of banking laws and regulations. An example of such loans to directors is the conglomeration of loans to Mr. Swan and related entities; PSB's net loans[3] to Swan and his related entities were approximately 70% of PSB's gross capital funds at December 31, 1981.

28. PSB and its directors filed with the OCC and published in local newspapers, Reports of Condition and Statement of Resources and Liabilities, respectively, for 12/31/81 which contained the following false information:

The loan loss allowance should have been presented in PSB's audited financial statements, call reports and counter statements for the year ended 1981 as at least $19,000,000 not $4,141,000.

PSB's "provision for possible loan losses" should have been presented as at least $21,000,000 rather than $6,343,000 in PSB's audited financial statements, call reports and counter statements for the year ended 1981.

The "income before income taxes" is overstated by an amount of at least $15,000,000 and should have been presented in PSB's audited financial statements, call reports and counter statements for the year ended 1981 as a loss of at least $8,000,000 rather than as income of $7,020,000.

[3] PSB's "net loans" means the amount on PSB's books excluding amounts participated out to other banks.

Net income should have been presented in PSB's audited financial statements, call reports and counter statements for the year ended 1981 as a net loss of at least $7,000,000 rather than as a net income of $4,725,000.

Equity capital should have been presented in PSB's audited financial statements, call reports and counter statements for the year ended 1981 as about $19,000,000 rather than $31,597,000, which would virtually eliminate undivided profits.

29. PSB and its Board of Directors filed with the OCC and published in local newspapers, Reports of Condition and Statements of Resources and Liability, respectively, for 3/31/82 which contain the following false information:

The loan loss allowance should have been fairly reported as approximately $44,500,000 rather than $4,500,000.

The provision for loan losses should have been fairly reported as approximately $43,000,000 rather than $3,019,000.

Pretax income should have been fairly reported as a loss before income tax benefit of approximately $34,000,000 rather than income of $2,126,000.

Net income should have been fairly reported as a net loss of approximately $33,500,000, rather than net income of $1,455,000.

Equity capital should have been fairly reported as negative equity capital of approximately ("$2,000,000").

30. The allowance for possible loan losses and provision for loan losses, net income and equity capital were material representations in the 12/31/81 and 3/31/82 financial statements issued by PSB.

Conclusions of Law:

1. This Court has jurisdiction over Wood Products' Complaint pursuant to 28 U.S.C. § 1331, 28 U.S.C. § 1332

(a), 12 U.S.C. § 1819 (Fourth) and 12 U.S.C. § 21, *et seq.*

2. PSB, through the FDIC as receiver of PSB, is liable for the fraud of the officers and directors of PSB, who were acting within the scope of their authority and on behalf of PSB. *Southwestern Bell Telephone Co.* v. *Brown*, 519 P.2d 491 (Okla. 1974); *Franklin Bond Corporation* v. *Smith*, 20 P.2d 912 (Okla. 1933).

3. PSB and its officers and directors prepared and published Statements of Condition and Statements of Income for each quarter and for year end including December 31, 1981 and March 31, 1982.

4. As described in the Findings of Fact, the representations in the December 31, 1981 and March 31, 1982 financial statements were false and misleading.

5. The PSB officers and directors made the representations knowing that the December 31, 1981 and March 31, 1982 allowance for possible loan losses and provisions for loan losses, net income and equity capital were false or misleading and that all documents that presented such information were false or misleading, or PSB officers and directors recklessly made those representations as positive statements knowing there was no reasonable ground for believing them to be true. It is not necessary to find that one individual in the bank had knowledge of all of PSB's problems and that those problems were not accurately reflected in the financial statements. The Court considers the *collegial* intent and knowledge of all the directors and officers to be the primary factor in its finding on the "intent" of PSB. Nevertheless, the Court finds that senior vice-president Bill Patterson's position was primary and unique. He was supervised only by Chairman Jennings both with respect to granting loans and setting policy and effectively as to the loan review function. The Court is satisfied by clear and convincing evidence that Patterson recklessly transferred data know-

ing it would be in the financial statements and knowing there was no reasonable ground for belief in its truth.

6. PSB officers and directors intended to defraud Wood Products because the PSB officers and directors intended to defraud all potential investors, depositors and creditors who would transact business with PSB in reliance upon representations of its sound financial condition. 74 Okla. Stat. § 4 (1981).

7. Wood Products relied on PSB's financial information received through PAM's Capital Adequacy Report. The reliance was evidenced by Wood Products' employee's notes on the Capital Adequacy Report.

8. Wood Products suffered injury as a result of PSB's fraud.

On the basis of the foregoing findings of fact and conclusions of law, the Court entered a verdict for Wood Products against the FDIC as Receiver of PSB for PSB's fraud.

II

CONSTRUCTIVE TRUST

The issue before the Court is, shall a constructive trust be imposed against the FDIC as receiver? The Court has been assisted by the briefs and oral arguments submitted by counsel.

The starting place for the Court's inquiry is the choice of law question. Should the Court apply federal or state law? The Court notes that nothing in the National Bank Act (12 U.S.C. § 21 *et seq.*) specifically pertains to this question even though the doctrine of ratable distribution applies in general. Therefore, the Court turns to judge-made law.

> The creditor rights of a depositor of a national bank, by virtue of his loan to the bank and the effects of the conduct of the bank as altering such

> rights, are determined by the law of the state of the deposit, in the absence of a federal statute creating a different relationship. There is no underlying general federal law determining such rights (Erie Ry. Co. v. Tompkins, 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188, 114 A.L.R. 1487), and no federal statute denying to a cestui his right against a bank as its trustee, where, in the course of its business prior to the receivership, such a trust relationship has been created by the conduct of the bank *Reno Nat. Bank of Reno, Nev.* v. *Seaborn*, 99 F.2d 482, 483 (9th Cir. 1938).

Accordingly, Downriver's and Wood Products' property rights in their funds held by PSB were established before PSB's failure and Oklahoma's law will be applied to determine those property rights. This ruling is consistent with the one in *FDIC* v. *Utica Nat'l Bank & Trust Co.*, CIV-83-974-W, slip op. at 19 (W.D. Okla. July 18, 1984), *aff'd in part and rev'd in part on other grounds*, No. 84-2148, slip op. (10th Cir. Nov. 26, 1986) 18[4] where the District Court stated, "Thus, state laws which create and define rights in the assets of a national bank prior to insolvency do not conflict with the principle of ratable distribution and are valid. In these cases at bar, the statutory and equitable rights to set-off existed before insolvency, even if they were exercised only afterwards, so they are not preempted."

The FDIC urges the Court to adopt the rule in *Kershaw* v. *Jenkins*, 71 F.2d 647 (10th Cir. 1934) that requires a person seeking a trust on assets of an insolvent bank to establish a fiduciary relationship between himself and the bank. However, from *Kershaw* it is impossible to

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[4] The Tenth Circuit affirmed the district court's ruling that beneficiaries (here, banks) of standby letters of credit were entitled to set off their claims against correspondent accounts maintained by PSB at the banks; the court reversed with respect to Liberty's setoff of its claim as confirming bank and Utica's claim for deposit for deposit insurance.

determine if the fiduciary relationship requirement was a. determined by the court to be part of federal judge-made law, b. state law or c. some general principle that the court assumed was state law. This Court chooses to apply state law.

The FDIC also refers the Court to *Hibernia Nat'l. Bank* v. *FDIC*, 733 F.2d 1403 (10th Cir. 1984), wherein the Tenth Circuit in dictum stated a party "seeking to impress a trust on an insolvent bank's assets . . . must first establish a fiduciary relationship and thereafter trace the trust property in its original or converted form into identifiable property in the receiver's possession." *Id.* at 1407. The Circuit Court cites only *Kershaw* for that proposition and this Court does not find support for the fiduciary relationship requirement in the cases cited in *Kershaw*. The Circuit Court does not discuss the fiduciary relationship further. Because the quotation above from *Hibernia* is dictum, this Court stands by its reasoning to apply state law to determine plaintiffs' rights that were created before PSB's insolvency.

In Oklahoma, if one person obtains title to another's property by fraud, equity imposes a constructive trust upon the property in favor of the person entitled to it. *Peyton* v. *McCaslin*, 417 P.2d 316 (Okl. 1966). See also *Marshall* v. *Amos*, 471 P.2d 896 (Okl. 1970). Here, the fraud committed by PSB through issuance of false financial statements has been established by clear and convincing evidence to the satisfaction of the jury, for Downriver, and the Court, for Wood Products. Therefore, plaintiffs are entitled to a constructive trust. Judge West's Order of June 15, 1984, in *Downriver* v. *FDIC*, CIV-83-69-W is consistent with this Court's independent analysis herein on the constructive trust issue.

In order to obtain a constructive trust, not only must plaintiffs prove PSB's fraud induced them to buy certificates of deposit, they must also prove augmentation of the receivership assets and tracing of their funds into the

hands of the receiver.[5] The evidence that plaintiffs transferred funds to PSB before its failure and that PSB's funds never dipped below an amount sufficient to cover plaintiffs' funds is uncontroverted. Therefore, plaintiffs have proven augmentation and tracing.

Is the National Bank Act preemptive so as to foreclose the constructive trust remedy against the receiver of an insolvent national bank? As noted above, the National Bank Act requires ratable distribution among holders of receivers certificates. 12 U.S.C. § 194. Ratable distribution does not, however, preclude identification and recovery of property that does not rightfully belong to the bank. *Fiman* v. *State of South Dakota*, 29 F.2d 776 (8th Cir. 1928). Therefore, the Court finds the National Bank Act is not preemptive where funds were obtained by the bank through fraud.

Having found the factual and legal prerequisites for imposition of a constructive trust, the Court next considers whether granting a constructive trust in favor of plaintiffs would be equitable. In this regard the Court must examine the impact on other holders of receiver's certificates. Wood Products provided two charts estimating the impact of the constructive trust and the parties stipulated that Paul Heafy, chief liquidator for PSB, would testify as follows: if the Court grants a constructive trust for Downriver's and Wood Products' lost principal and interest, the other receiver's certificate holders would receive eight tenths of one percent (.8%) less than if the Court does not grant the constructive trust. That

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[5] Although the Court has found no Oklahoma cases that discuss augmentation and tracing, authority on this issue is sparse and other jurisdictions, e.g. *Converse Rubber Co.* v. *Boston-Continental Nat'l. Bank*, 12 F.Supp. 887 (D. Mass. 1935), have imposed the augmentation and tracing requirements on parties seeking a constructive trust. This Court expects the Oklahoma courts would similarly require proof of augmentation and tracing if faced with the issue in this case.

reduction applies to all receiver's certificate holders, including the FDIC, which holds forty-seven percent of the total. The Court finds that reduction, though not de minimis, could not be regarded as such a burden as to render inequitable the recognition of the property rights of plaintiffs.[6]

Other uninsured depositors could have sued the bank and its receiver as these plaintiffs did or they could have intervened in this case pursuant to Federal Rules of Civil Procedures 24(a). The vindication of their property rights is up to those other depositors, not the FDIC.

> Appellant seriously and forcibly contends that, on the broad principle of equitable rights, to permit the state, under the circumstances here disclosed, to obtain a prior right on the funds in the insolvent bank in such a large amount, is inequitable and unjust to the creditors and depositors of the bank, and invokes the rule as to the rights of innocent third persons. He also insists that the depositors should be considered as cestui que trustent and that their rights should be considered on an equality with those of the plaintiff. However, it is not for the defendant herein, but for those whose rights are thus claimed, to raise and establish any such equality of rights. *Fiman* v. *State of South Dakota*, 29 F.2d 776, 782 (8th Cir. 1928).

Wood Products argued that the constructive trust should be imposed against the future dividends to be paid

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[6] The issue of the effect of a constructive trust on uninsured depositors only comes up when people have invested more than the FDIC insurance limit in a failed bank. Representatives of money brokers testified that after Penn Square failed, most of their investor-clients spread funds in several banks to have FDIC insurance on all monies invested in banks and stopped investing in jumbo certificates of deposit. Therefore, the Court believes this Order will have little precedential effect on the constructive trust issue.

to the FDIC in its corporate capacity.[7] If the FDIC alone bore the reduction in dividends, uninsured depositors would incur no reduction in future dividends. Wood Products asserts the equities weigh in favor of having the FDIC bear the reduction in dividends because the FDIC is an insurer and had input in the decision-making process that resulted in the closing of PSB. The FDIC could protect itself better than credit union investors could. Wood Products' argument is appealing, but because the FDIC's right to share ratably with uninsured depositors to recover amounts paid to insured depositors is statutory, the Court is compelled to reject Wood Products' argument on this issue.

The Court has found that plaintiffs are entitled to a constructive trust on their lost principal and that imposing a constructive trust is equitable in this case. The question remaining is whether plaintiffs should also receive a constructive trust on the lost interest on their funds held by PSB. The dispositive issue is the choice of law as discussed above. Plaintiffs refer the Court to cases in which a claimant in equity of funds held by a receiver is entitled to interest as well as principal. *Bd. of Com'rs. of Sweetwater County, Wyo.* v. *Bernardin*, 74 F.2d 809 (10th Cir. 1934); *Mothersead* v. *United States Fidelity & Guaranty Co.*, 22 F.2d 644, 654 (8th Cir. 1927), *cert. denied*, 276 U.S. 637 (1928); *American Surety Co.* v. *Carbon Timber Co.*, 263 F. 295, 303 (8th Cir. 1919); *Spring Coal Co.* v. *Keech*, 239 F. 48, 53 (4th Cir. 1916). However, none of those cases pertain to the receiver of an insolvent national bank subject to the National Bank Act. The Court is persuaded that the controlling law on the issue of prejudgment interest is federal law because federal law applies to any post-insolvency rights of plaintiffs. If state law conflicts with

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[7] The FDIC in its corporate capacity holds receiver's certificates for the amount it paid to depositors for FDIC insurance. 12 U.S.C. § 1821(g).

federal law, the latter applies concerning the distribution of assets of an insolvent national bank. *Rushton* v. *Schram*, 143 F.2d 554 (6th Cir. 1944). With respect to the receivership of an insolvent national bank, "interest accruing on a claim after insolvency cannot be paid unless the assets are sufficient to pay all claims in full, because to pay interest on one while others are unpaid in whole or in part would violate the exaction of ratable distribution of assets." *Fash* v. *First Nat. Bank of Alva, Okla.*, 89 F.2d 110, 112 (10th Cir. 1937).

Downriver asserts it is entitled to a constructive trust on its wire transfer claim. One of the four certificates of deposit ($1 million each) Downriver had in PSB matured on July 2, 1982. First United Fund ("FUF"), Downriver's money broker, transmitted wiring instructions to PSB on July 2, 1982 to wire the one million dollars from the maturing certificate of deposit to another bank. The funds were not wired and remained in PSB on July 5, 1982. The jury found that FUF was negligent in its attempt to have the funds wired. Downriver also sued PSB for the alleged fraud of Bert Davis, a PSB vice-president; Downriver alleged Bert Davis told FUF the funds were being wired and thus led FUF to believe no further action needed to be taken. The jury found Bert Davis did not commit fraud with respect to Downriver's wire transfer claim. Therefore, Downriver cannot rely on fraud to support its constructive trust theory on the wire transfer claim.

Downriver presented two alternative theories, besides fraud of PSB, to support its right to recover a constructive trust on the one million dollars; they are breach of fiduciary duty and segregation of assets. Downriver argues when PSB accepted the wiring instructions, PSB became Downriver's agent for purposes of transferring the funds to the other bank and that as Downriver's

agent, PSB breached its fiduciary duty by failing to transfer the funds and failing to disclose that PSB's Federal Reserve wire had been closed. For the proposition that PSB became Downriver's agent, for the wire transfer, Downriver relies on *Bryan* v. *Coconut Grove Bank & Trust Co.*, 132 So. 481 (Fla. 1931). In *Bryan*, the bank accepted a check on which it was both the drawee and the payee for purpose of transferring the funds to another bank. The funds were not transferred before the drawee became insolvent. The court imposed a constructive trust because the bank became the drawer's agent by accepting the check. While the statements of law in *Bryan* generally support Downriver's argument, the facts do not. Assuming PSB received the wiring instructions, no new obligation of PSB was created. In *Bryan*, the court found that by accepting the check, the bank created a special fund for the drawer. Here the Court finds no special fund was created when PSB received the wiring instructions.

For its third theory in support of a constructive trust on the wire transfer claim, Downriver argues its funds were segregated because its certificate of deposit was taken from the PSB vault to the certificate of deposit department on July 2, 1982. The Court is not persuaded that this set of facts supports recovery based on a segregation theory because placing the certificate of deposit in a folder in the certificate of deposit department did not segregate the funds. The one million dollars was still part of the general assets of the bank. Accordingly, the Court has found no basis for a constructive trust on Downriver's wire transfer claim.

In accordance with the findings and conclusions stated above, a judgment shall be entered in favor of Wood Products for $182,062.50 and Downriver for $1,772,-

208.58;[8] the Court finds a constructive trust shall be imposed against the PSB receivership assets for those amounts.

It is ORDERED this 15th day of December, 1986.

/s/ Wayne Alley
WAYNE E. ALLEY
United States District Judge

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[8] Those amounts are calculated as follows.

	Wood Products	Downriver
Receiver's Certificate	$ 404,583.32	$ 3,938,240.00
Less Dividends Received as of December 10, 1986	(222,520.82)	(2,166,031.42)
	$ 182,062.50	$1,772,208.58

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF OKLAHOMA

No. CIV-82-1357-A

Consolidated With:

No. CIV-83-69-A
No. CIV-83-1583-A
No. CIV-83-3117-A
No. CIV-84-1596-A
No. CIV-84-1612-A
No. CIV-84-1663-A
No. CIV-84-1671-A
No. CIV-84-1672-A

PROFESSIONAL ASSET MANAGEMENT, INC.,
a California corporation,
Plaintiff,

vs.

PENN SQUARE BANK, N.A., *et al.*,
Defendants.

JOURNAL ENTRY OF JUDGMENT

[Filed Dec. 23, 1986]

On December 15, 1986, this Court issued written finding of fact and conclusions of law memorializing the Court's oral findings and conclusions made on September 19, 1986, ruling that the FDIC, as Receiver of Penn Square Bank, N.A., was liable to Wood Products Credit Union for fraud. On September 19, 1986, the jury also

reached a verdict finding the FDIC, as Receiver of Penn Square Bank, N.A., liable to Downriver Community Federal Credit Union for fraud.

On December 15, 1986, this Court further ordered that both Wood Products Credit Union and Downriver Community Federal Credit Union were entitled to a constructive trust against the Penn Square Bank receivership assets for the amount of the principal lost by Wood Products Credit Union and Downriver Community Federal Credit Union as a result of Penn Square Bank, N.A.'s fraud.

The Court hereby Orders in conformance with the above findings, conclusions, Order and Verdict that:

1. Wood Products Credit Union is awarded a judgment of $182,062.50 against the FDIC, as Receiver of Penn Square Bank, N.A.

2. Downriver Community Federal Credit Union is awarded a judgment of $1,772,208.58 against the FDIC, as Receiver of Penn Square Bank, N.A.

3. A constructive trust is hereby imposed against the assets of the Penn Square Bank receivership as of July 5, 1982 in the amount of $182,062.50 in favor of Wood Products Credit Union.

4. A constructive trust is hereby imposed against the assets of the Penn Square Bank receivership as of July 5, 1982 in the amount of $1,772,208.58 in favor of Downriver Community Federal Credit Union.

5. The FDIC, as Receiver of Penn Square Bank, N.A., shall pay in cash forthwith, the sum of $182,062.50 to Wood Products Credit Union and $1,772,208.58 to Downriver Community Federal Credit Union in liquidation of the corpus of each trust.

6. Upon payment of the corpus of the trust property, defendant will have no further obligation to make payment of receiver dividend distributions on account of Downriver Community Federal Credit Union's or Wood Products' certificates of deposit in Penn Square Bank, N.A. Nothing herein shall affect the obligation of the FDIC, as Receiver of Penn Square Bank, N.A., to pay dividends to the plaintiffs prior to the time this judgment is fully satisfied, provided the FDIC, as Receiver of Penn Square Bank, N.A., shall be entitled to a credit against the amounts awarded herein for the amount of any dividends paid out to Wood Products Credit Union or Downriver Community Federal Credit Union after the date this judgment is entered and prior to fully satisfying this judgment.

7. Post judgment interest at the rate of 5.77% beginning December 23rd, 1986, shall accrue on the sum of $182,062.50 as to Wood Products Credit Union and on the sum of $1,772,208.58 as to Downriver Community Federal Credit Union until these judgments are fully satisfied.

8. The FDIC, as Receiver of Penn Square Bank, N.A., shall pay all costs as provided by either F.R.C.P. 54(d) or 28 U.S.C. § 1920.

DATED this 23rd day of December, 1986.

/s/ Wayne Alley
WAYNE E. ALLEY
United States District Judge

Entered this 23rd day of December, 1986.

Entered in Judgment Docket on 12-23-86.

APPROVED AS TO FORM:

/s/ Robert Wiener
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Receiver for Penn Square Bank, N.A.

APPENDIX D

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF OKLAHOMA

No. CIV-83-69-A

DOWNRIVER COMMUNITY FEDERAL CREDIT UNION,
Plaintiff,

v.

FEDERAL DEPOSIT INSURANCE CORPORATION, *et al.*,
Defendants.

No. CIV-84-1663-A

WOOD PRODUCTS CREDIT UNION,
Plaintiff,

v.

PENN SQUARE BANK, N.A., *et al.*,
Defendants.

Consolidated with:

No. CIV-82-1357-A
No. CIV-83-1583-A
No. CIV-83-3117-A
No. CIV-84-1596-A
No. CIV-84-1612-A
No. CIV-84-1671-A
No. CIV-84-1672-A

ORDER

[Filed Mar. 27, 1987]

The Court has for consideration the Federal Deposit Insurance Corporation's (FDIC) Motion for New Trial and Downriver's and Wood Products' Motion to Amend Judgment. The Court has broad discretion in ruling on the motion for new trial. *Thompson v. Kerr-McGee Refining Corp.*, 660 F.2d 1380, 1388 (10th Cir. 1981).

In its motion for new trial the FDIC submits that the constructive trust portion of the December 15, 1986 Order was in error on the choice of law issue, the equitableness of granting a constructive trust to these plaintiffs and the preemption of the ratable distribution requirement of the National Bank Act. Those issues were briefed at length before, during and after the trial. The Court remains convinced that state law governs pre-insolvency rights of the parties. While discussing the ratable distribution requirement and a bank's right to setoff, the Supreme Court stated,

> liens, equities, or rights arising by express agreement, or implied from the nature of the dealings between the parties, or by operation of law, prior to insolvency and not in contemplation thereof, are not invalidated. . . . The requirement as to ratable dividends, is to make them from what belongs to the bank, and that which at the time of the insolvency belongs of right to the debtor does not belong to the bank.

Scott v. Armstrong, 146 U.S. 499, 510 (1892). Under Oklahoma law, the plaintiffs' funds did not belong to Penn Square when it failed. Equity imposes a constructive trust upon property in favor of a person who has been defrauded. *Peyton v. McCaslin*, 417 P.2d 316 (Okl. 1970). Therefore, plaintiffs were awarded a constructive trust because of Penn Square's pre-insolvency fraud.

The FDIC has presented no new theories to support its argument that the constructive trust imposed is inequitable and contrary to the ratable distribution re-

quirement of the National Bank Act. The Court stands by its reasoning that the receiver must "ratably distribute" only property that belongs to the bank at the time of insolvency and therefore, the National Bank Act is not preemptive where funds were obtained by the bank through fraud.

The Court now turns to the plaintiffs' motion to amend judgment. Plaintiffs request that the Court reconsider its denial of post-insolvency interest on their funds held by Penn Square. Plaintiffs rely on *Ticonic Nat'l. Bank v. Sprague*, 303 U.S. 406 (1938) to support the proposition they are entitled to post-insolvency interest. In *Ticonic*, the issue was

> whether or not a secured creditor of a national bank, holding a non-interest bearing claim, is entitled to interest for any period subsequent to the insolvency of the bank, when the assets on which he has a lien are sufficient to pay the principal and interest but the total assets of the bank are not sufficient to pay in full all creditors' claims as of the date of insolvency.

Id. at 407. The constructive trust imposed by this Court does not rise to the level of a trust secured by bonds as described in *Ticonic*, where the plaintiff had a statutory lien. Consequently, the Court will not alter its ruling on post-insolvency interest.

Accordingly, the FDIC's motion for new trial is denied and plaintiffs' motion to amend judgment is denied.

It is so ORDERED this 27 day of March, 1987.

/s/ Wayne Alley
WAYNE E. ALLEY
United States District Judge

APPENDIX E

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

Nos. 87-1645, 87-1648

DOWNRIVER COMMUNITY FEDERAL CREDIT UNION,
Plaintiff-Appellant

v.

FEDERAL DEPOSIT INSURANCE CORPORATION, in its capacity as Receiver for Penn Square Bank, N.A.,
Defendant-Appellee

Nos. 87-1649, 87-1707

WOOD PRODUCTS CREDIT UNION, an Oregon Credit Union,
Plaintiff-Appellee,

v.

FEDERAL DEPOSIT INSURANCE CORPORATION, in its capacity as Receiver for Penn Square Bank, N.A.,
Defendant-Appellant,

ORDER

[Filed Sept. 5, 1989]

Before HOLLOWAY, MCKAY, LOGAN, MOORE, ANDERSON, TACHA, BALDOCK, BRORBY, EBEL, Circuit Judges, and O'CONNOR, District Judge *.

This matter comes on for consideration of appellants' petition for rehearing and suggestion for rehearing en banc in the captioned cause.

Upon consideration whereof, the petition for rehearing is denied by the panel that rendered the decision sought to be reheard.

In accordance with Rule 35(b) of the Federal Rules of Appellate Procedure, the petition for rehearing and suggestion for rehearing en banc were transmitted to all the judges of the court in regular active service. No member of the hearing panel and no judge in regular active service on the court having requested that the court be polled on rehearing en banc, Rule 35, Federal Rules of Appellate Procedure, the suggestion for rehearing en banc is denied.

Judge Seymour did not participate in consideration of the petition.

Entered for the Court
ROBERT L. HOECKER
Clerk

/s/ Patrick Fisher
By PATRICK FISHER
Chief Deputy Clerk

---

* Of the United States District Court for the District of Kansas, sitting by designation.

APPENDIX F

LIST OF AUTHORITIES

A fraudulent misrepresentation directed towards the public or a class of persons is deemed to be a fraudulent misrepresentation as to every individual in the public or class who relied thereon.

37 C.J.S. *Fraud* § 22(2) (1943)

37 Am.Jur.2d *Fraud and Deceit* §§ 193, 244 (1968)

Restatement (Second) of Torts § 531 (1976)

Simms v. Tigrett, 229 Ala. 486, 158 So. 326, 330 (1934)

Carville v. Jacks, 43 Ark. 454 (1884)

Wennerholm v. Stanford University School of Medicine, 20 Cal.2d 713, 128 P.2d 522 (1942); Cal. Civ. Code § 1711 (Deering 1971)

Gulf Oil Corp. v. Newton, 130 Conn. 37, 31 A.2d 462 (1943); *Salmon v. Richardson*, 30 Conn. 360 (1862)

Hines v. Wilson, 164 Ga. 888, 139 S.W. 802, 804 (1927)

Wollenberger v. Hoover, 346 Ill. 511, 179 N.E. 42 (1931)

Wells v. Western U. Tel. Co., 144 Iowa 605, 123 N.W. 371, 377 (1909)

Campbell v. Gooch, 131 Kan. 456, 292 P. 752, 754 (1930)

Graham v. John R. Watts & Son, 238 Ky. 96, 36 S.W.2d 859, 861 (1931)

Holloway v. Forsyth, 226 Mass. 358, 115 N.E. 483 (1917)

Dime Savings Bank v. Fletcher, 158 Mich. 162, 122 N.W. 540 (1909)

Stevens v. Ludlum, 46 Minn 160, 48 N.W. 771 (1891)

Webb v. Rockefeller, 195 Mo. 57, 93 S.W. 772 (1906); *Chison County Bank v. Byers*, 139 Mo. 627, 41 S.W. 325 (1897)

Bank of Valley v. Mattson, 215 Neb. 596, 339 N.W.2d 923, 927 (1983)

Rohrschneider v. Knickerbocker Life Ins. Co., 76 N.Y. 216 (1879); *Tindle v. Birkett*, 171 N.Y. 520, 64 N.E. 210 (1902)

Hart v. Hanson, 14 N.D. 570, 105 N.W. 942 (1895); N.D. Cent. Code § 9-10-05 (1987)

Bartholomew v. Bentley, 15 Ohio 659 (1846)

Coughlin v. State Bank of Portland, 117 Or. 83, 243 P. 78, 82 (1926)

Gillespie v. Hunt, 276 Pa. 119, 119 A. 815, *cert. den.* 261 U.S. 622 (1923)

Whitbeck v. Sees, 10 S.D. 417, 73 N.W. 915 (1898); S.D. Codified Laws § 20-10-3 (1987)

Martin v. Miller, 24 Wash.App. 306, 600 P.2d 698, 701 (1979)

APPENDIX G

LIST OF AUTHORITIES

One who acquires property by fraud, misrepresentation, duress or undue influence, holds the property in constructive trust for the transferor.

89 C.J.S. *Trusts* § 146 (1955)

76 Am.Jur.2d *Trusts* § 221 (1975)

Restatement of Restitution § 166 and § 215, comment (e) (1936)

Knowles v. Canant, 255 Ala. 331, 51 So.2d 355 (1951); *Bevels v. Hall*, 246 Ala. 430, 21 So.2d 325 (1945)

Eckert v. Miller, 57 Ariz. 94, 111 P.2d 60 (1941)

Bainbridge v. Stoner, 16 Cal.2d 423, 106 P.2d 423 (1940)

Harper v. Adametz, 142 Conn. 218, 133 A.2d 136 (1955)

Osin v. Johnson, 100 U.S.App. D.C. 230, 243 F.2d 653 (D.C. Cir. 1957)

Bell v. Smith, 59 Fla. 817, 32 So.2d 829 (1947)

Bateman v. Patterson, 212 Ga. 284, 92 S.E.2d 8 (1956); *Sykes v. Reeves*, 195 Ga. 587, 24 S.E.2d 688 (1943)

Peine v. Murphy, 46 Hawaii 233, 377 P.2d 708, 713 (1962)

Fresh v. Dunakin, 306 Ky. 87, 206 S.W.2d 203 (1947); *Moore v. Terry*, 293 Ky. 727, 170 S.W.2d 29 (1943)

Strout v. Burgess, 144 Me. 263, 68 A.2d 241 (1949)

Bowie v. Ford, 269 Md. 111, 304 A.2d 803 (1973)

State Street Bank & Trust Co. v. Beale, 353 Mass. 103, 227 N.E.2d 924 (1967)

Potter v. Lindsay, 337 Mich. 404, 60 N.W.2d 133 (1953)

Blumberg v. Taggart, 213 Minn. 39, 5 N.W.2d 388 (1942)

Pitchford v. Howard, 208 Miss. 567, 45 So.2d 142 (1950)

Wallach v. Joseph, 420 S.W.2d 289 (Mo.), *cert. den.* 389 U.S. 953 (1967)

Hensley v. Stevens, 156 Mont. 486, 481 P.2d 694 (1971); Mont. Code Ann. § 72-20-111 (1987)

Meier v. Meyer, 153 Neb. 222, 43 N.W.2d 502 (1950)

Villalon v. Bowen, 70 Nev. 456, 273 P.2d 409 (1954)

Patey v. Peaslee, 101 N.H. 26, 131 A.2d 433 (1957)

D'Ippolito v. Castoro, 51 N.J. 584, 242 A.2d 617 (1968)

Central National Bank of Mineola v. Robinson, 281 N.Y. App.Div. 700, 117 N.Y.S.2d 530 (1952); *Beatty v. Guggenheim Exploration Co.*, 225 N.Y. 380, 386, 122 N.E. 378 (1919)

Security National Bank of Greensboro v. Educators Mutual Life Ins. Co., 265 N.C. 86, 143 S.E.2d 270 (1965)

Barker v. Barker, 75 N.D. 253, 27 N.W.2d 576 (1947)

Steener v. Fecycz, 72 Ohio App. 18, 50 N.E.2d 617 (1942)

Barnsdale State Bank v. Springer, 176 Okla. 479, 56 P.2d 390 (1936)

Legler v. Legler, 187 Or. 273, 211 P.2d 233 (1949); *Suitter v. Thompson*, 225 Or. 614, 358 P.2d 267 (1960)

In re Gordon, 328 Pa. 129, 195 A. 122 (1937)

Lawrence v. Andrews, 84 R.I. 133, 122 A.2d 132 (1956)

Greene v. Brown, 199 S.C. 218, 19 S.E.2d 654 (1946)

Johnson v. Graff, 71 S.D. 231, 23 N.W.2d 166 (1946)

Rutherford County v. City of Murfreesboro, 202 Tenn. 455, 304 S.W.2d 635 (1957); *McNeill v. Dobson-Bainbridge Realty Co.*, 184 Tenn. 99, 195 S.W.2d 626 (1946)

Meadows v. Bierschwale, 516 S.W.2d 125 (Tex. 1974)

Decorso v. Thomas, 89 Utah 160, 50 P.2d 951, *reh. den.* 57 P.2d 1406 (1935)

McGann v. Capital Sav. Bank & Trust Co., 117 Vt. 179, 89 A.2d 123 (1952)

Murdoch v. Leonard, 1 Wash.2d 37, 95 P.2d 37 (1939)

Annon v. Lucas, 155 W.Va. 368, 185 S.E.2d 343 (1971)

Glojek v. Glojek, 254 Wisc. 109, 35 N.W.2d 203 (1948)

FILED
JAN 29 1990
JOSEPH F. SPANIOL, JR.
CLERK

No. 89-697

In the Supreme Court of the United States

OCTOBER TERM, 1989

DOWNRIVER COMMUNITY FEDERAL CREDIT UNION, ET AL., PETITIONERS

v.

PENN SQUARE BANK, THROUGH ITS RECEIVER, FEDERAL DEPOSIT INSURANCE CORPORATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the ratable distribution requirement of the National Bank Act precludes the establishment of a constructive trust on behalf of an individual creditor of a failed national bank in the absence of a showing that the bank's fraud caused a particular harm to the creditor not shared by substantially all other creditors and that granting relief to the creditor would not disrupt the orderly administration of the receivership estate.

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In the Supreme Court of the United States

OCTOBER TERM, 1989

No. 89-697

DOWNRIVER COMMUNITY FEDERAL CREDIT UNION, ET AL., PETITIONERS

v.

PENN SQUARE BANK, THROUGH ITS RECEIVER, FEDERAL DEPOSIT INSURANCE CORPORATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-21a) is reported at 879 F.2d 754. The order and judgment of the district court (Pet. App. 22a-45a) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on July 3, 1989. A petition for rehearing was denied on September 5, 1989 (Pet. App. 49a-50a). The petition for a writ of certiorari was filed on October 31, 1989. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner Downriver Community Federal Credit Union held about $4 million in certificates of deposit from Penn Square Bank and petitioner Wood Products Credit Union held about $500,000 in the Bank's certificates of deposit on July 5, 1982, when the Bank was declared insolvent by the Comptroller of the Currency and ordered closed. The Federal Deposit Insurance Corporation (FDIC) was appointed receiver of the Bank. After being paid $100,000 each, the amount of their insured deposits, Downriver and Wood Products applied for and were issued Penn Square Bank receiver certificates for the amount of their uninsured deposits. Each has received more than half of its uninsured funds. Pet. App. 3a-4a.

Petitioners sued the FDIC as receiver for Penn Square Bank in the United States District Court for the Western District of Oklahoma, seeking to recover all of their uninsured funds. They claimed that Penn Square Bank held those funds in constructive trust for their benefit because it had induced their deposits by issuing financial statements that materially misstated the Bank's financial condition. Pet. App. 3a-4a. The cases were consolidated for trial. In the liability phase, Downriver tried its fraud claim to a jury and Wood Products tried its claim to the court. Both triers of fact returned verdicts in favor of petitioners, finding that Penn Square Bank's December 31, 1981, and March 31, 1982, financial statements contained material misrepresentations; that those representations were relied upon by petitioners; and that the Bank's management either knew that the financial statements contained false or misleading information or recklessly made those representations

knowing that there were no reasonable grounds for believing them to be true. *Id.* at 4a.

The district court then addressed the remedial question—whether a constructive trust could be imposed on the assets held by the receiver for the benefit of petitioners. The court first held that Oklahoma law, rather than federal law, should be applied in deciding whether to impose a constructive trust. Pet. App. 34a. It further held that petitioners had satisfied the prerequisites for the imposition of a constructive trust under Oklahoma law. Specifically, it found that Penn Square Bank had obtained their deposits by fraud; that the deposits had augmented Penn Square Bank's assets; and that the deposits could be traced into assets held by the receiver. *Id.* at 35a-36a. The court also determined that the constructive trusts vested under Oklahoma law at the time of the original deposits, and then concluded that petitioners' funds were not subject to the ratable distribution requirements of the National Bank Act. The district court acknowledged that 12 U.S.C. 194 "requires ratable distribution among holders of receivers certificates," but the court thought that ratable distribution was not required in the case of "property that does not rightfully belong to the bank." Pet. App. 36a.

Although the district court imposed a constructive trust on the assets held by the receiver to the extent of the principal amount of the deposits and the interest accrued to the date Penn Square Bank was declared insolvent, the court denied petitioners' claims for post-insolvency, prejudgment interest. It held that "the controlling law on the issue of prejudgment interest is federal law because federal law applies *to any post-insolvency rights of* [*the*] *plaintiffs.*" Pet. App. 38a (emphasis added). The court

concluded that interest accruing on a claim after insolvency cannot be paid unless the assets are sufficient to pay all claims in full, since to pay interest on one claim while other claims remained unpaid in whole or in part would violate Section 194's requirement that assets be distributed ratably. Pet. App. 39a.

2. The court of appeals held that the district court erred by imposing a constructive trust on any of petitioners' deposits. Pet. App. 1a-21a.

a. The court of appeals first concluded that federal law governed. It acknowledged that Congress has not enacted specific legislation governing the pre-insolvency relationship between a national bank and its depositors, but noted that it has enacted specific legislation governing the distribution of assets of a national bank after the insolvent bank is closed. That legislation requires a ratable distribution of assets among all general creditors entitled to share in the receivership estate—Section 194 provides that "the comptroller shall make a ratable dividend * * * on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction." It also precludes payments by bank officers that prefer some creditors to others—12 U.S.C. 91 provides that "the preference of one creditor to another * * * shall be utterly null and void." Pet. App. 8a-9a.

In light of Congress's directions with respect to the distribution of a failed bank's assets, the court of appeals held that "[a]s of the moment that a national bank is declared insolvent and goes into the hands of a receiver, federal law governs the distribution of the bank's assets." Pet. App. 9a. Thus, the court concluded, "[a]ll state laws inconsistent with the 'system of equal distribution' established by the

National Bank Act are preempted" (*ibid.*, quoting *Jennings* v. *United States Fidelity & Guar. Co.*, 294 U.S. 216, 226 (1935)), since "[i]n no other way could there be unity of administration, and a carrying out of the federal mandate of equality" (Pet. App. 9a, quoting *First Nat'l Bank* v. *Selden*, 120 F. 212, 215 (7th Cir. 1903)). The court further explained (Pet. App. 10a) that the National Bank Act must be read in conjunction with the Federal Deposit Insurance Act, which specifically provides that where the FDIC is acting as the receiver of a federal bank all suits are "deemed to arise under the laws of the United States" (12 U.S.C. 1819 Fourth).

The court of appeals concluded that petitioners could not avoid the application of federal law by claiming that their equitable right to the funds arose prior to insolvency. The court held that "[t]he equitable fiction of trusts relating back to the date that the plaintiffs deposited their funds in PSB * * * does not change the fact that by purchasing a certificate of deposit in PSB, the plaintiffs intended a debtor and creditor relationship," not one of beneficiary and trustee. Pet. App. 11a.

However, the court noted that "[t]he relevant provisions of the National Bank Act admittedly do not provide explicit guidance for the disposition of all claims against the receiver's estate." Pet. App. 12a. The court therefore went on to state that even though it had decided that federal law governs the petitioners' claims, that did not necessarily preclude the imposition of a constructive trust in accordance with Oklahoma law: "In fashioning the federal common law in this area we may look for guidance to the law of the state having the closest connection to the transaction at issue when to do so would not conflict with

the need for uniform rules governing bank liquidations." Pet. App. 13a (quoting *FDIC* v. *Palermo*, 815 F.2d 1329, 1334 (10th Cir. 1987)). But the court determined that the National Bank Act's "unfriendliness to special interests requires a claimant seeking a preference from pro rata distribution of assets to bear a heavy burden of proof." Pet. App. 15a (citing *Hibernia Nat'l Bank* v. *FDIC*, 733 F.2d 1403, 1408 (10th Cir. 1984)). The court held that a "national bank's fraudulent conduct may give rise to a constructive trust only when the plaintiff can show that the bank's fraud caused a particular harm that is not shared by substantially all other depositors, and that granting relief to the plaintiff does not disrupt the orderly administration of the receiver's estate." Pet. App. 15a.

b. With respect to petitioners' claims, the court of appeals determined that the fraudulent statements contained in Penn Square Bank's financial statements were not directed specifically to the two credit unions. Pet. App. 19a. It concluded that "[i]n the absence of a false and fraudulent representation made specifically to the plaintiff, with respect to the financial condition of the [bank], the plaintiff has no equity superior to the rights of other depositors or creditors of the [bank], who made deposits in said [bank] in reliance upon the statements published by said [bank]." Pet. App. 20a (quoting *Beacon Mfg. Co.* v. *Hood*, 204 N.C. 349, 351, 168 S.E. 523, 524 (1933)).

The court rejected petitioners' suggestion that unequal treatment of depositors could be avoided by permitting all depositors similarly situated to the plaintiffs to sue as a class. It determined that Congress had not intended to deluge the FDIC with

claims for preferences on behalf of all the uninsured depositors who could show that they relied upon misleading information that was available to all depositors. Rather, the court determined, "[a]ny remedy for fraudulent representations that affects, or potentially affects, all creditors belongs to the receiver, who asserts such claims for the benefit of all creditors" and distributes the proceeds on a pro rata basis. Pet. App. 21a.

ARGUMENT

The court of appeals correctly held that federal law rather than state law governs petitioners' claims and that petitioners are entitled to no preference under the facts of this case. Since its decision does not conflict with any decision of this Court or another court of appeals, further review is not warranted.

1. a. Although state law generally governs the relationship of a bank with its customers, "[s]tate law governance of the preinsolvency contracts of national banks is limited * * * by the paramount authority of Congress to regulate national banks." Pet. App. 8a.

> National banks are instrumentalities of the federal government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States. It follows that an attempt by a state to define their duties or control the conduct of their affairs is absolutely void, wherever such attempted exercise of authority expressly conflicts with the laws of the United States, and either frustrates the purpose of the national legislation or impairs the efficiency of these agencies of the federal government to discharge the duties for the performance of which they are created. These principles are axiomatic, and are sanctioned by the repeated adjudications of this court.

Davis v. *Elmira Sav. Bank*, 161 U.S. 275, 283 (1896). Relying on these principles, the court of appeals correctly held that, following a determination that a bank is insolvent, federal law preempts state law since Congress has enacted legislation governing the distribution of a failed bank's assets. Pet. App. 9a (citing *American Surety Co.* v. *Bethlehem Nat'l Bank*, 314 U.S. 314, 316-317 (1941), and *First Nat'l Bank* v. *Selden*, 120 F. 212, 215 (7th Cir. 1903)).

Petitioners contend that state law should apply here because, under it, their *pre*-insolvency relationship with Penn Square Bank was that of beneficiary and trustee. But petitioners' intention in depositing their funds in Penn Square Bank was to establish the relationship of debtor and creditor. See *Bank of Marin* v. *England*, 385 U.S. 99, 101 (1966) (absent a showing of specific intent to the contrary, the relationship of a bank to its depositors is that of debtor and creditor founded upon contract). Petitioners seek to change their relationship with Penn Square Bank *post*-closing to one of trustee and beneficiary. Despite the equitable fiction that a constructive trust arises at the time of the fraud, the characterization of the relationship of petitioners and the Bank is a post-insolvency matter governed by federal law.

b. Under federal law, no constructive trust is warranted under the facts of this case. As the court of appeals noted (Pet. App. 8a-9a), Section 194 states that creditors are to receive a "ratable dividend." Thus, as the court of appeals held (Pet. App. 15a), a creditor of an insolvent bank seeking a preference must overcome a heavy presumption to the contrary. Petitioners—who have merely shown that they relied on misleading statements in Penn Square Bank's financial reports—have not carried their burden. They

have established no particular harm to them not shared by other depositors. Indeed, the district court acknowledged that the Bank's "officers and directors intended to defraud all potential investors, depositors and creditors." *Id.* at 33a.

The imposition of a constructive trust under the facts of this case would undermine the ratable distribution rule since, if a depositor could receive full repayment of uninsured funds simply by demonstrating that he based his investment decision on a bank's financial statements and that those statements proved to be misleading, then most creditors of a failed national bank would have claims for full repayment. Many if not most institutions which fail have at some point made material misstatements of their financial condition, and most investors can be said to rely to some degree on the publicly disseminated financial statements of banks in which they invest. As the court of appeals stated, permitting some creditors to receive a preferential recovery by filing lawsuits (and thus depleting the estate's assets) quickly, despite the fact that all creditors similarly situated would have the same claim, would make "the equality promised to them * * * a mere mockery." Pet. App. 21a (quoting *National Bank* v. *Colby*, 88 U.S. (21 Wall.) 609, 614 (1875)).

2. Contrary to petitioners' contentions (Pet. 9, 10, 16), there is no conflict in the circuits on the question presented. Petitioners cite no decision, and we know of none, where a court of appeals approved the imposition of a constructive trust in a case like this one.

In *Reno Nat'l Bank* v. *Seaborn*, 99 F.2d 482 (9th Cir. 1938), a depositor had instructed the Bank to transfer the depositor's funds to another institution

and the Bank promised to do so but did not. The Bank then became insolvent, and the depositor sought to recover in full. The court of appeals concluded that there was no need for federal uniformity with respect to the question at issue (*id.* at 483), but went on to hold under state law that the depositor should not be treated more favorably than other creditors. The decision not to provide a preference in *Reno Nat'l Bank* is not in conflict with the decision not to provide a preference in this case. Moreover, not only is the result in *Reno Nat'l Bank* in accord with that of the decision in this case, the court's decision to consult state law is not necessarily in tension with the reasoning of the court below. As it explained, in applying federal common law, a court "may choose to adopt state law." Pet. App. 11a-12a n.6. Furthermore, the court below suggested that the imposition of a constructive trust might be appropriate where, as in *Reno Nat'l Bank*, a depositor suffered a particular harm not shared by other creditors. See Pet. App. 16a.

That was the case in *Fiman* v. *South Dakota*, 29 F.2d 776 (8th Cir. 1928), cert. denied, 279 U.S. 841 (1929). In *Fiman*, the State's rural credit board had made uninsured deposits in violation of a state law that restricted the amount that it could deposit in any particular institution; thus, its claim was based on a particular law that was not applicable to other depositors. The court of appeals concluded that the State's deposits had "been distinguished and pointed out as money belonging to the state." *Id.* at 783. In this case, in contrast, petitioners' deposits have not been distinguished from those of other creditors, since petitioners, like other depositors, relied to their detriment on Penn Square

Bank's misleading financial statements, which were available to all depositors.

Nor is *FDIC* v. *Braemoor Associates*, 686 F.2d 550 (7th Cir. 1982), cert. denied, 461 U.S. 927 (1983), in conflict with the decision here. In that case the FDIC was acting as the receiver of a state bank rather than a federal bank (see Pet. App. 10a & n.5), and the court decided to apply state law in "the absence of any ready-made federal common law." 686 F.2d at 554. There was an absence of federal law because that case did not involve a depositor seeking to obtain an exception from the National Bank Act's ratable distribution requirement. Rather, the FDIC was attempting to recover money that the president of the failed bank had funneled from the bank to a real estate venture in which he was a partner.

Finally, there is no merit to petitioners' claim that the court's decision conflicts with cases construing federal bankruptcy law. Specifically, petitioners contend that the court of appeals' determinations of what constitutes an asset of a debtor's estate and whether property obtained by fraud may be retained for the benefit of that estate are inconsistent with determinations of the same issues under the Bankruptcy Act. But the court's decision does not permit the receivership estate to retain any funds fraudulently obtained. It merely provides that where all creditors are similarly harmed, the assets of the estate should be ratably distributed among all creditors. That result is in accord with the federal bankruptcy laws requiring ratable distribution of assets among creditors of the same class.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

DOWNRIVER COMMUNITY FEDERAL CREDIT UNION and WOOD PRODUCTS CREDIT UNION,
Petitioners,

v.

PENN SQUARE BANK, through its Receiver, FEDERAL DEPOSIT INSURANCE CORPORATION,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

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REPLY BRIEF FOR THE PETITIONERS

The Brief for the United States in Opposition ("Resp. Br.") fails to justify the court of appeals' sweeping encroachment on areas of law traditionally reserved by Congress and this Court for the states, and fails to diminish the patent conflict between the circuits which was created by the decision below. Both the opinion of the court of appeals (Pet. App. 1a-21a) and the Respondent's brief demonstrate a troubling willingness to upset a time-honored balance between state and federal interests under which state law determines the nature of pre-insolvency property interests. As shown below, the arguments advanced by the Respondent for ignoring the controlling precedents with which the opinion below conflicts are misleading and erroneous.

Contrary to the Respondent's suggestion (Resp. Br. 7-8), there is no conflict between the state law which created the Petitioners' constructive trusts and the ratable distribution requirement of the National Bank Act and, accordingly, there is no preemption of state law in this case.[1] The ratable distribution requirement applies only to the assets of national banks, not to assets of others held in trust by banks. The sole question is whether the Petitioners' trust funds were assets of Penn Square Bank when that bank failed. Absent express legislation by Congress, the pre-insolvency character of a national bank's assets is and always has been determined by state law.

The court of appeals and the Respondent address this gap in their analysis by arguing that the Petitioners are attempting to *change* their relationship with Penn Square Bank post-insolvency. Resp. Br. 8. To the contrary, the Petitioners are defending *against* such change. It is the FDIC as receiver who seeks to alter the Petitioners' pre-insolvency trustee/beneficiary relationship after insolvency. Whether a debtor/creditor or trustee/beneficiary relationship was created when Penn Square Bank fraudulently obtained the Petitioners' funds is a question of

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[1] Under the standard enunciated in *Davis v. Elmira Sav. Bank*, 161 U.S. 275, 283 (1896) and cited by Respondent (Resp. Br. 7-8), the conflict between state and federal law must be *express* in order for the federal law to preempt state law. In *Davis*, the Court held that state law was preempted where an express conflict existed between New York law, which provided that debts due to savings banks by insolvent banks were to be preferred over debts due to other creditors, and federal law, which provided for ratable distribution under the National Bank Act. Moreover, the Court explicitly distinguished the facts in *Davis* from situations where the relation was not that of an ordinary creditor, such as where by state law a lien is created apart from the insolvency, or where a creditor has a claim on a specific fund. 161 U.S. at 288-289. In those instances, since funds of the claimants are not assets of the bank, they are not subject to the requirement of ratable distribution. *Id.* Such is the case here.

state law. Under Oklahoma law, at the moment those funds were obtained by fraud, a constructive trust, not a debtor/creditor relationship, automatically arose. No intention by the parties to create a trust was required. The Respondent has cited absolutely no authority for the proposition that intention to create a trust is required to establish a constructive trust,[2] and no further action by the Petitioners was necessary to create that property right. By nature, a constructive trust arises irrespective of the intent of the parties. The relationship of trustee/beneficiary remained unchanged through the bank's failure and until the Tenth Circuit's decision.

The Respondent next argues that, regardless of the nature of a constructive trust as a vested property right under state law, a federal court can ignore such state law property rights because they are only an "equitable fiction . . . governed by federal law". Resp. Br. 8. Neither the court of appeals nor the Respondent has cited any support for such an audacious proposition, and as shown in the Petition, the proposition conflicts with the intention of Congress and the decisions of a number of other circuits. *See* Pet. 8-12 and 21-23 (discussion of conflicting decisions and Congressional statements of intent regarding constructive trusts and the role of state trust law for national banks). This attempt to downgrade the state law of trusts to a "fiction" would in effect overturn a century-long standard for determining

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[2] Respondent erroneously states that *Bank of Marin v. England*, 385 U.S. 99 (1966) stands for the proposition that "absent a showing of specific intent to the contrary, the relationship of a bank to its depositors is that of debtor and creditor founded upon contract." Resp. Br. 8. In fact, in *Bank of Marin*, the Court said *nothing* about the specific intent of the parties being required in order to establish a relationship other than that of debtor/creditor. The case did not involve an attempt to establish a relationship other than debtor/creditor between the bank and the depositor; it merely involved the question of whether the voluntary bankruptcy of the depositor (without notice to the bank) altered the obligations of the bank under the debtor/creditor contract to honor checks drawn by the depositor.

what property in the possession of a failed bank is actually an asset of that bank or is property belonging to another which the bank only holds in trust.

The Respondent's attempts to smooth out the clear conflicts created among the circuits by the decision below are erroneous and misleading. The Ninth Circuit in *Reno Nat'l Bank v. Seaborn*, 99 F.2d 482, 483 (9th Cir. 1938), unequivocally held that state law governed the question of the character of the assets prior to and at the time of insolvency and the question of whether the pre-insolvency conduct of a national bank had created a constructive trust prior to the bank's failure. *Reno Nat'l Bank* was not a case of federal preemption softened by the court's discretionary selection of state law as the rule of decision, as suggested by the Respondent.[3] Resp. Br. 10. The decision below remains in direct conflict with the Ninth Circuit, which would have applied state law in this case.

The conflict created with the Eighth Circuit remains equally unresolved. The Respondent's explanation of *Fiman v. South Dakota*, 29 F.2d 776 (8th Cir. 1928), *cert. denied*, 279 U.S. 841 (1929), has no relationship to the Eighth Circuit's actual reasoning in the case. The Respondent states that the *Fiman* court awarded the constructive trust because the depositor's claim was unique to that single depositor and its deposits had " 'been distinguished and pointed out as money belonging to the [depositor].' " Resp. Br. 10 (*quoting Fiman*, 29 F.2d at 783). The only distinction drawn in *Fiman* between the trust claimant and other depositors with potential con-

[3] Perhaps the most revealing aspect of the Respondent's analysis is its contention that, notwithstanding the fact that the Ninth Circuit in *Reno Nat'l Bank* and the decision below are diametrically opposed on the question of federal preemption, there is no conflict because *the end result was the same*: the trust claim was denied. This same result-oriented reasoning lies at the heart of the court of appeals' analysis. Both the Respondent and the court below show a dangerous willingness to compromise important precepts of federalism for the expedient result of maximizing the recovery of the FDIC as the major creditor of Penn Square Bank.

structive trust claims was that the trust claimant had prosecuted its claim and others had not. The language quoted out of context by the Respondent related solely to the fact that the trust claimant had satisfied the requirements for augmentation and tracing, not that the trust claimant had any unique claim as suggested by the Respondent. As in *Fiman*, the Petitioners have proven their pre-failure entitlement to the trust funds and have traced those trust funds into U.S. Treasury bills purchased by the receiver. *Fiman* remains in direct conflict with the decision below in this case because *Fiman* explicitly places the burden on other depositors to prove their claims, not on the trust claimant to disprove the possibly competing claims of others. 29 F.2d at 782.

Similarly, the Respondent failed to diminish the conflict with the Seventh Circuit's decision in *FDIC v. Braemoor Associates*, 686 F.2d 550 (7th Cir. 1982), *cert. denied*, 461 U.S. 927 (1983). Judge Posner held that state law would be applied as the rule of decision in a constructive trust case where, as in the present case, the stated basis for federal jurisdiction and application of federal law was 12 U.S.C. § 1819 Fourth. Judge Posner found a presumption that state law applied due to "the absence of any ready-made federal common law in most of the areas of law in which it might be applied, and a general reluctance to displace state law without explicit statutory or constitutional direction to do so." 686 F.2d at 554. Neither the court of appeals nor the Respondent have shown that such a presumption has been rebutted in this case. No federal common law decision has been cited where a constructive trust claim against a national bank was denied because the property was fraudulently obtained by means of misleading financial statements as opposed to other fraudulent misrepresentations. There is no "ready-made federal common law" in this area. More important, there is absolutely no explicit statutory authority to preempt state law of trusts. Indeed, Congress, not the courts, is the proper authority to determine if a

wholesale elimination of pre-insolvency state law rights is necessary to ensure the expeditious administration of bank liquidations. *See* Pet. 25.

Finally, the Respondent's effort to distinguish the conflicting bankruptcy cases is unpersuasive. As the Petition explains, the decision of the court below creates a different standard for applying the ratable distribution requirement under the National Bank Act than that which is uniformly applied under federal bankruptcy law. Pet. 7-12. The court of appeals' decision is in conflict with the bankruptcy decisions of this Court and a number of circuits on the question of whether state or federal law governs the pre-insolvency creation of a constructive trust. *Id.* The Respondent's brief fails to address this issue head-on. Instead, it attempts to obfuscate the issue by stating that the decision below "merely provides that where *all* creditors are similarly harmed, the assets of the estate should be ratably distributed among all creditors." Resp. Br. 11 (emphasis added). The assertion that all creditors of Penn Square Bank were similarly harmed in this case is demonstrably inaccurate. The largest single creditor, the FDIC, holds almost half of the dollar value of all creditor claims and could not possibly have relied upon Penn Square Bank's financial statements in becoming a creditor.[4] Indeed, the unstated agenda that plainly fuels the FDIC's vigorous opposition is that, by defeating the application of state constructive trust law, it will be able to share ratably in assets that

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[4] The FDIC is a creditor solely as a result of the contractual risk undertaken by the FDIC years before the bank's failure to insure the deposits of Penn Square Bank. The FDIC received premium payments from Penn Square Bank for years to compensate for that risk, and more important, the FDIC undertook to insure Penn Square Bank long before the fraudulent financial statements were ever issued. Thus, aside from the obvious unlikelihood that *all* Penn Square Bank depositors relied on the bank's misleading financial statements, it is clear that the largest creditor of Penn Square Bank could not possibly have relied on the bank's financial statements and therefore could not possibly be "similarly harmed".

properly belong to the Petitioners because the Petitioners, not the FDIC, were defrauded.

In the final analysis, enrichment of the FDIC Bank Insurance Fund at the expense of the Petitioners appears to have been the intended result of the Tenth Circuit's decision. As the Ninth Circuit observed in *Morrison-Knudson Co. v. CHG International, Inc.*, 811 F.2d 1209, 1216 (9th Cir. 1987), and this Court recognized in *Coit Independence Joint Venture v. FSLIC*, 489 U.S. ——, 109 S.Ct. ——, 103 L.Ed.2d 602 (1989), irrespective of the pressing problems of the banking industry, federal courts are not free to effect wholesale revisions of established law in response to current changes in national conditions. That task properly belongs to Congress.

CONCLUSION

For the foregoing reasons and those stated in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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